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The Risks Facing the World Economy

A Study Group Report

Table of Contents

	Page
Preface	1
Introduction	2
1. Positive Aspects of the Current Situation	5
2. A Major Recession	11
3. Stagflation	25
4. Policy Recommendations	30

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Preface

This report is based on the deliberations of a small Study Group set up by the Group of Thirty after its September 1990 plenary meeting.

At that time, it seemed that the world economy faced several international difficulties. While it was generally acknowledged that these difficulties created a risk of a long and severe recession — or accelerating inflation — it did not seem that they were receiving the systematic attention they deserved. A month before our September meeting, oil prices had spiked upward as a result of the invasion of Kuwait by Iraq. The risk of a worldwide surge in inflation suddenly seemed imminent and the economic and financial condition of the Organization for Economic Cooperation and Development (OECD) nations looked a good deal more fragile than it had a few weeks earlier. It seemed possible that the luck of the industrial countries might have run out and that their neglect of certain fundamental problems during the 1980s might shortly come home to roost.

Sure enough, soon afterwards, the economic outlook of the industrial countries did deteriorate, although perhaps not quite in the way that we had feared. For, while the threat of a recession in the United States became a reality, the threat of a third major oil crisis receded soon after the start of the Gulf Crisis. Now, in the early spring of 1991, there are some initial signs of improvement. Still, significant risks remain.

The focus of this report is deliberately on these downside risks as they now appear, but that is not meant to reflect any particular gloom on the part of the Study Group. The paper is an exercise in contingency analysis for the world economy, an attempt to consider in a coherent way what might go wrong and what can be done to prevent or ameliorate it. If events turn out favorably, the fundamental problems that underlie the risks discussed here will still have to be addressed in due course. If, however, the world economic outlook deteriorates once more, the policy challenge could become urgent.

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With the exception of Charles Taylor, all the members participated in the Study Group in their personal capacity. The views and judgments expressed here do not reflect the policies of their institutions in any way.

Introduction

The purpose of this report is to review the macroeconomic risks facing the industrial economies over the next eighteen months and to discuss the associated policy challenges. These risks, as always, are of less economic activity or more inflation than expected. In the present circumstances, "less activity" translates into a risk of a deep and protracted recession in the industrial countries if recent initial signs of a US recovery turn out to be misleading or if the upturn is so weak that, after a pause, it is aborted.

The risk of "more inflation" translates into a return to stagflation after a shallow recession. It is conceivable that core inflation might accelerate quite quickly in one or more of the major industrial countries — to, say, over 8% a year as it did in the late 1970s. Perhaps commodity prices will pick up sharply and monetary policy be consistently accommodating. But such high inflation seems unlikely now and a scenario of relatively little growth and inflation that resumes its disconcerting upward drift from 5% to, say, 6 or 6.5% over the next two years or so seems more probable.

The rest of this report is divided into four sections. The next section gives due consideration to the positive aspects of the current world economic situation, with reference to earlier periods of economic difficulty. The following section reviews in some detail the risk of a long and severe recession, after which the risks of stagflation are discussed. The final section lays out the broad considerations we believe should underlie policy at this time.

Positive Aspects of the Current Situation

Quite aside from the tentative, initial signs of recovery in the United States, there are basic aspects of the current situation that are encouraging — or potentially encouraging — and they need to be acknowledged.

Inflation Expectations

First and foremost, inflationary expectations seem not to have risen greatly. As far as one can tell, there was little upward shift in inflationary expectations when oil prices doubled in the late summer of 1990. This is in marked contrast to what happened during the last two oil shocks in 1973-74 and 1979-80.

Inflationary expectations cannot be measured directly — there is no way to measure or aggregate the states of mind of innumerable individuals — but indirect evidence strongly supports this view, considering what happened to nominal interest rates on bonds.

Excluding the effects of taxes, these nominal rates are made up of the real rate of return that investors demand and borrowers expect to pay and the inflation rate both expect over the life of a bond. In the United States, for example, the yield on long-term government bonds peaked in September 1990 at 8.9%, up only 0.5% over the trough for the year of 8.4% in July. It then fell back below that level early in 1991. Of course, this reflected the downturn in economic activity there — investors were prepared to accept a lower real return under the circumstances. But it also suggests there was very little expectation that the surge in oil prices would ratchet overall inflation rates upward.

Compare this with the experience during the 1978-80 oil crisis when average oil import prices rose about 130%. That did drive up general inflation rates and forced the interest rate on US Treasury bonds up from 8.5% to over 14% — roughly a 6% increase — before it peaked in 1981. By that time, expectations must have been that inflation would stay at around 10% for the next ten years or so, which turned out to be wildly pessimistic: inflation actually fell below 4% only two years later and stayed there for most of the 1980s.

Of course, the rate of inflation as measured by consumer prices has moved upward in the past six months in the major industrial countries. But the core rate, which is adjusted to exclude the volatile food and energy components, has eased, at least in the United States.

The bottom line is that inflationary expectations remain modest. This contrast to the 1979-81 experience is strong testimony to the credibility that the central banks have built up during the 1980s as guardians against inflationary shocks.

Market Flexibility

Over the past decade, one of the remarkable changes in the industrial countries has been the increase in market flexibility — in labor and capital markets and the markets for goods and services.

- Organized labor lost some of its appeal as the political spectrum shifted to the right in many industrial countries. In response, it adapted by accepting more flexible working rules. And, in Europe and North America, high rates of unemployment throughout most of the decade have strengthened the hand of management against labor.
- The deregulation and globalization of financial services facilitated extraordinary international capital movements. Volatility is evidence of capital market flexibility — its responsiveness to events — as well as of periodic speculative excesses.
- The increased international competition in goods markets has made it more difficult for national cartels to insulate themselves from technological and market changes, sudden or gradual. Many industries have introduced flexible manufacturing techniques and lowered break-even points, increasing their ability to respond quickly to good and bad developments alike.

Still, labor markets and the markets for many goods and services are not as flexible as they might be. In several European countries, laws and regulations that protect jobs and inhibit new hiring contribute to high levels of structural unemployment. In the United States, many of the unskilled have found neither work nor training for long periods of time. And, throughout the industrial countries, unemployment still rises when a recession starts, which is evidence in and of itself that real wages are still downwardly sticky.

Equally, many products, including those subject to international competition, are produced and sold by oligopolies. Some industries, where there are major economies of scale in essential research and development, are quite concentrated even at a global level. Government procurement practices support national and local oligopolies in many countries. This effectively limits the responsiveness of prices to changes in demand. And, in services — within government and in the medical services sector in particular — competitive pressures continue to be muted in most industrial countries, with similar results.

But, even with these qualifications, the general point still stands that markets are more flexible today than they were 10 years ago.

What does this imply? Most importantly in the current situation, it means that shocks — such as the summer oil price increase — flow out through the international economy without meeting too many obstacles, until their force is dissipated. The recent sudden threat of oil scarcity was translated into a large rise in crude oil prices, then a significant rise in gasoline prices, then a moderate rise in transportation prices and then finally into a small rise in the cost of most consumer goods. And, equally important, as oil prices then fell, gasoline prices fell too and there is a good chance that the decline will restrain price increases for consumer goods and services in general.

Still, the threat of sustained higher oil prices last summer led consumers to expect their real incomes to fall. No doubt it lowered consumer spending in several industrial countries in the second half of 1990. But, because of the flexibility of markets, consumer expectations about income must have improved marginally when oil prices subsequently fell.

Policy Improvements

The third of our positive circumstances is not an exogenous factor in the situation facing policymakers. It is an observation about some of the policymakers themselves. Still, it belongs here for one good reason: several disaster scenarios are predicated implicitly on the idea that the monetary authorities in one of the major industrial countries will make a major mistake. And this seems unlikely on the face of it.

Important lessons of the past have been well learnt. The policy response to the oil shock in 1990 and to the subsequent downturn has been firm and balanced. This time, there was no attempt to restrain the flow of higher energy costs into the economy. The shock was met, not with gasoline quotas or subsidies but with a somewhat more restrictive monetary policy and a promise, which was credible throughout most industrial countries, of tighter monetary policy if indeed the core rate of inflation had picked up as a result of the oil price shock. The two actions stopped inflation rising in the short term.

Looking back to the 1987 stock market crash, the central banks were alert and responsive. Not only did they intervene in the capital markets to prevent any disruptive failures that could have posed a systemic risk but they also offset the potential negative effects of a decline in wealth on aggregate demand by promptly loosening monetary policy. While, with hindsight, it seems that they overshot the mark in lowering interest rates and stimulating demand rather too much, that can fairly be attributed to the considerable inherent uncertainties in the situation at that time, rather than any error of judgment. This is in marked contrast to the part that they played in the 1930s in exacerbating the 1929 Crash. At that time, the Federal Reserve did not offset the decline in the money multiplier as innumerable commercial bank failures reduced the ratio of base money to credit extended to the economy at large.

Finally on this score of central bank competence, it is a comfort in the present situation to note that they work together closely in many ways. There is a free exchange of information on policy and strong coordination at the technical level in market operations and supervision and regulation. While differences continue to arise about the substance of monetary and exchange rate policies, the G-7 central banks — that is, the central banks of Canada, France, Germany, Italy, Japan, the United Kingdom and the United States — and the other major industrial country central banks, share the common central objectives of establishing and then maintaining price stability, and maintaining the safety and soundness of the international financial system. They speak the same language.

Asynchronicity

A fourth blessing in the current situation has more recent roots than the preceding three, which have all evolved gradually over the past several years. It is the asynchronicity of this downturn. That is to say, the recession is concentrated in the Anglo-Saxon economies. Elsewhere, generally, demand is holding up.

Statistics for the final quarter of 1990 show that GNP is clearly falling in the United Kingdom, the United States, Australia and Canada; and more recent reports of industrial production and unemployment confirm that the contraction has continued into the new year. In most of continental Europe outside Germany, recent industrial production numbers also show output falling. But there is every sign that domestic demand and output in the western part of Germany, in Japan — and in much of East Asia for that matter — continue to expand.

It is too early to say if asynchronicity will see the industrial countries through their current difficulties. Earlier, when it was clear only that demand in the Anglo-Saxon economies was turning down, it looked as though continental Europe might be stronger. German imports may have surged as a result of the reconstruction effort in the east. But, because of the initial strategy, now reversed, of financing public sector support for the reconstruction with borrowing, higher interest rates emanated from Germany until March of this year. Demand and output faltered in France and Italy.

In 1979, when demand was weakening dramatically in the United States, Germany and Japan remained buoyant; the rest of the industrial countries stood somewhere in between. But that did not prevent the subsequent general recession. Still, Germany and Japan are a larger share of total industrial-country GNP now than they were 10 years ago and, although growth forecasts have been revised downward recently, the engine of domestic growth looks difficult to derail in the near term, at least in Germany.

For the United States, net exports should stimulate demand soon. The dollar's March rally has been too short to negate the effect of its steady decline over the previous 18 months. As the lagged effects of that larger decline take hold, US exports should become increasingly price competitive while the price of imports relative to domestically produced goods should be less appealing. Likewise, currency depreciation should stimulate net external demand for Australia and New Zealand and, to a lesser extent, for Canada.

The United Kingdom, however, is now tied to the deutsche mark through the Exchange Rate Mechanism of the European Monetary System (EMS). British producers will face tougher competition from the United States and other countries that have devalued. Once inflation has stabilized, they should benefit from a drop in real interest rates — short rates have already fallen — but it will take time for the relatively new British exchange rate policy to establish credibility in the markets and, until then, a risk premium will keep UK interest rates higher than they otherwise would be.

In sum, Germany and Japan have confounded many observers by becoming important engines of demand for the world economy in the early 1990s. Their expansion may yet offset the current contraction in the Anglo-Saxon economies. But it is hard to believe that their relative buoyancy will be such a potent force for recovery as was hoped just a few months ago. Asynchronicity may turn out to be a significant blessing, but it is far from being a sure one.

Inventories

The last of the blessings to be counted in the current situation is a mixed one: the low level of inventories at the outset of the recessions in the Anglo-Saxon economies.

At the start of past recessions, firms typically found that they overestimated demand for their products. Orders were cut and inventories built up. As a result, soon after the recession began, these firms and their suppliers cut output more than the decline in demand, leading to lower income for the industrial workforce. These workers spent less, demand fell further and the downturn was reinforced.

In this recession, however, firms have been very careful in managing their inventories. Better inventory management techniques introduced over the past 10 years have kept stocks low. There was relatively little excess inventory accumulation before or after the peak in this cycle. The dip in activity and, hence, in demand is likely to be less severe than it otherwise would have been.

However, there is a dark side to this phenomenon. In past recessions, anticipatory inventory restocking soon after the trough in economic activity contributed to the recovery as it increased income and demand. This will not happen in the present cycle because more responsive firms can trust their quick reflexes to meet orders when they materialize and do not need to anticipate the trend by producing ahead of demand. So, while the absence of a traditional inventory cycle may mitigate against the depth of the current recession, it is also likely to work against the strength of the ultimate recovery.

A Major Recession

What would constitute a major recession and what might cause one to come about?

There is something fundamentally arbitrary about a definition of a "major" recession, especially when it involves thinking about economic performance in several countries. So any precise formulation should be taken with a pinch of salt. But, on the other hand, some degree of specificity is needed to understand clearly the risks at hand.

A reasonable standard would seem to be a recession that was more severe than the previous two — in 1974-75 and in 1980-82. Both times, it took several years for the combined GNP of the G-7 countries to recover to the trend that could have been sustained at full capacity. Measured as this difference between actual GNP and the trend, the "cost" of the 1974-75 recession was equivalent to a 10% loss of G-7 GNP in 1973, the year before the recession began. The 1980-82 recession was about twice as serious, "costing" 20% of GNP. In both cases, the number and depth of actual down-quarters was small, adding up to about a 2% absolute drop in total G-7 GNP. But the consequent shift below trend and several other quarters of low growth were enough to lead to these large costs as measured in terms of GNP below capacity.

At first glance, this might not seem so severe a standard for the current economic outlook, but if GNP in Germany and Japan continue to grow at all, such a downturn would only happen if GNP elsewhere in the G-7 falls by about 3% over the next few quarters and stays well below capacity for some years to produce a 10% total loss of G-7 GNP relative to trend. If the German and Japanese economies, which now account for over a third of G-7 GNP, continue to expand steadily at an annual rate in excess of, say, 2%, the decline elsewhere would have to exceed 4% of GNP.

What, then, might bring about such a major, if uneven, contraction? Several factors could play a part. We can weave them, for expositional purposes, into a single gloomy scenario:

- As a result of the high levels of personal and corporate debt, consumer and business confidence, and hence demand, do not sustain their rebound after the end of the Gulf War. Equally, the real estate recovery in the United States — and the United Kingdom — falters and real estate prices in Japan drop sharply, depressing confidence there.
- At the same time, the US banking sector continues to perform poorly, which keeps the cost of capital high for most banks and makes them freshly cautious about lending. The credit crunch intensifies. Then the Federal Reserve fails to increase liquidity and lower short-term rates — or it does so, but excess reserves accumulate in the banking system as banks remain guarded about lending, and creditworthy households and businesses refuse to borrow — a liquidity trap.
- The restraining effect on the recession of normal fiscal stabilizers in the United States is muted by the federal fiscal deficit and associated fiscal problems.
- At the same time in the EMS, high real interest rates prevent the United Kingdom from recovering and generally depress demand there. The possibility of a realignment within the EMS results in an interest rate premium for the weaker currencies, exacerbating this effect.
- The Federal Reserve tries to break out of a liquidity trap by easing short-term rates, but this causes the dollar to fall back below its recent lows. Or, for fear of a dollar fall, the Federal Reserve forebears, and short-term interest rates remain too high to stimulate demand. Thus, market uncertainties about international financial arrangements constrain the Federal Reserve, contributing to a deeper recession.

Although problems in one area could easily reenforce problems in another, this litany of woes is plainly unlikely to be realized in every respect. Nonetheless, it is worth considering how the component problems could develop and contribute to a severe recession to understand what kinds of preventive measures may be needed in the near future.

Confidence

The Gulf Crisis has been widely cited as a proximate cause of the recession. It is argued that the prospect of conflict contributed to the sharp decline in consumer and business confidence in the second half of 1990 and thus to the decline in spending and, ultimately, income.

This may be true, but it cannot be the whole story — or even the half of it. Families with soldiers involved in the conflict may have had a reason to be very cautious about their financial future. But there was no concrete reason why the majority of businesses or consumers would have lost much confidence once the price of oil returned to the $20s per barrel, even in the period when war seemed likely and the cost to the allies in terms of human lives was most uncertain.

As we noted before, when oil prices initially rose, it was reasonable for households and businesses to expect real incomes to fall and to adjust their spending plans accordingly. As measured by the US business organization, the Conference Board, confidence did fall sharply in Italy, France and Germany in August and September last year, after Iraq invaded Kuwait. In Canada and the United States, however, a steep decline was evident earlier in the year; it continued. In Japan, confidence had peaked in late 1989 and, while it remained high, it ebbed through the third and fourth quarters of 1990. In the United Kingdom, confidence has been on an uptrend since April 1990, although the absolute level was still depressed at the end of the year.

This pattern of generally weak and declining confidence in advance of the Gulf Crisis, which is also evident in surveys of business investment intentions internationally, suggests that the crisis reinforced an existing trend rather than started one. Now the war is over, some confidence may have been restored, as current US survey data suggests. But, sharp as the recovery in measured confidence has been in the United States, it remains lower than it has been at any time since 1983, and it is quite possible that the uptick will be limited in scale and duration.

Why was confidence ebbing beforehand? In the United States and Europe, profits and income had already started to fall before the Gulf Crisis broke in the summer of 1990. Plans for cutting white collar as well as blue collar jobs were widely announced, so that income expectations had become a good deal less certain.

What made these developments so threatening was the high level of debt built up in the last 10 years. The vague unease caused by debt from time to time during the expansion changed to alarm at the prospect that asset prices were beginning a major decline and that income might fall below the level necessary to cover debt service. The natural reaction — to raise precautionary savings sharply — unfortunately implies a further reduction in consumption and aggregate demand. Can these concerns about debt and recession be allayed, now that the war is over?

Debt

The accumulation of corporate and household debt in the 1980s, not just in the United States but in many industrial countries, makes this an unusual period in recent economic history. In the United States, private debt as a share of GNP was fairly stable from the early 1940s to the early 1980s; and with public debt included as well the relationship to GNP was extremely stable. The last time public and private debt was at current levels — about 1.9 times GNP — was in prelude to the Great Depression.

How did the accumulation of debt come about this time? So far as the United States is concerned, at the start of the last decade high actual and expected rates of inflation combined with preferential tax treatment of interest expenses over other capital costs to encourage increased use of debt financing by corporations. Subsequently, the rise in the value of real and financial assets relative to corporate income sustained the trend. Then the wave of merger and acquisition activity in the second half of the decade had the effect of raising debt levels, when debt was used either to help finance acquisitions or to repel them.

US business debt rose from 53% to 65% of GNP between 1980 and 1989. Moreover, during the expansion, the rate of bankruptcy was high in the business sector — at least twice the post-World War II average, measured by the liabilities of failing businesses as a percent of GNP. It is reasonable to expect, therefore, an unusually large number of work-outs and bankruptcies in this recession. What is not clear, however, is the extent to which extensive financial distress in the business sector will have an impact on the real economy.

The evidence of the 1980s and recent analysis suggests that work-outs and bankruptcies do create additional inefficiencies in medium-scale and large firms that have public debt in their balance sheets, because it is difficult to renegotiate. But the inefficiencies are probably too small to have a discernible direct impact in the macroeconomic context. The operations of medium-scale and large companies that depend on bank debt are even less likely to be affected by the threat, or the actual fact of a work-out or a bankruptcy. They simply continue to operate.

However, the increased chance of bankruptcy that accompanies heavy debt and the start of a recession has dramatically increased the cost of debt to many companies. The spread between junk and treasury bonds doubled in the third quarter of 1990 from 6% to 12%. That of itself can discourage production and investment and contribute to the downturn.

Moreover, bankruptcies have knock-on effects, especially where a large financially distressed firm is an important customer for smaller companies. Small trade creditors, having delivered goods or services and while awaiting payment, may be forced into liquidation if a settlement awards them a fraction of the face value of their claims.

How could this be so? These smaller firms will generally have debts only to banks and individual creditors such as their own suppliers. Sometimes these creditors may have a long-term working relationship with the business. Other ~~times,~~ the business itself is a new start-up. Either way, these smaller firms may find that their assessment of future business prospects diverges from that of their creditors: once bitten, twice shy. With imperfect information about what business prospects really are, there will be times when the creditors make the wrong decision and force a firm into liquidation when it could have continued to operate profitably after a work-out. These times may well be more frequent in this recession, where the business sector is more heavily indebted than it has been in the past.

While the corporate sector was taking on more debt during the 1980s, so was the household sector of many industrial countries. US data shows household debt rose 15% as a share of GNP, from 52% to 67% between 1980 and 1989. Some preliminary work by the Federal Reserve suggests that US households that incurred above average debt had above average assets in the late 1980s. But their asset values may have declined since then and, in any case, households that were heavily indebted relative to income may have grown relatively more numerous during the 1980s: young families, borrowing to buy homes, may have incurred more debt than earlier cadres of homebuyers to finance higher-priced homes because they — and their creditors — expected these homes to continue to rise in value. In other words, within the household sector, there may be relatively few older creditor households in healthy financial condition and relatively many younger debtor households in serious financial straits compared with previous recessions.

The same general trends have been observed in the United Kingdom and Japan. There is some evidence that the balance sheet of the household sector in all three countries deteriorated in 1990, mainly because of the decline in the stock market in Japan and in real estate in the United Kingdom and the United States. In the United States, home prices and sales volumes of single family homes have declined while the number of homes available to be sold rose nationwide in the second half of 1990. The median sales price of single family homes peaked in July and had dropped 7% by November.

The plight of debtor households may exacerbate the downturn, because relatively small falls in house values can make it financially very difficult to sell a home with a large mortgage and relocate, thereby curtailing future income opportunities. It would be surprising if the confidence of households in that situation rebounds quickly. For households, the costs of bankruptcy are high.

So it is quite possible that if the recession lasts the high level of corporate and household debt will keep confidence depressed and borrowing costs high, resulting in costly disruptions especially for smaller businesses. These effects may in turn deepen the recession.

Financial Fragility

Two domestic financial systems seem particularly frail for the moment — those of the United States and Japan. Of the two, the situation in the United States appears to be more threatening and can be delineated much more clearly.

US Banks. The 1980s were difficult years for US banks. Most money center banks began the decade with significant third world debt problems. While they were provisioning for these, they were losing large corporate business as the nonfinancial firms discovered they could often raise capital and credit more cheaply by going directly to the markets than they could through a bank. In the inflationary late 1970s, commercial banks large and small were losing household depositors to money market mutual funds that were free to offer high interest rates. To compete, banks were then allowed by their regulators to offer products at the retail level that had much narrower spreads.

While the commercial banks worked hard to cut costs and improve the attractiveness of their products, they also responded to competition by pursuing new, more risky lines of business to maintain profits. Early in the decade, several invested in the energy sector, and later on, others invested more heavily and directly in real estate, which grew as a share of bank assets from 30% to over 40%. Some became heavily involved in financing highly leveraged mergers and acquisitions. And many became dependent on fee income, which, although not risky, is unstable.

As a result, it is not surprising that the industry faced difficulties as these sectors declined one after another during the second half of the 1980s. As the expansion slowed and then stopped in 1990, asset quality deteriorated, affecting more banks throughout the country. Provisioning increased and, recently, dividend payments were cut. Stock prices were severely hurt and credit ratings reduced. It became increasingly difficult and expensive for the banks to raise capital — precisely when they most needed to do so for prudential reasons and to meet the international capital adequacy standards that are currently being phased in.

The rate of bank failures is likely to remain quite high for the next few years. It is virtually certain that the Bank Insurance Fund, which underpins the federal system of bank deposit insurance, will have to be recapitalized within the next few months. Congressional action on this score has just been proposed by the US Treasury in the context of wider reforms. This and a series of other proposals put forward by industry groups, individual government agencies and various members of Congress would affect the powers of banks, the division between banking and commerce, the extent of deposit insurance and the US regulatory structure.

The precise nature of most of these proposals is unimportant so far as the near term macroeconomic outlook is concerned. What may matter is that, while these structural issues are being addressed, there is limited public confidence in the federal government's process and institutions.

Evidence of this is the number of small retail runs on banks in the past few months. The public debate about the recapitalization of the Bank Insurance Fund is only vaguely understood. Depositors realize that the fund is near to going bust itself and, unfortunately and erroneously, they infer that they should withdraw their funds from weak institutions, "just to make sure."

Nonetheless, it is unlikely that even a series of major retail bank runs would cause the US banking system to unwind. Any bank facing a liquidity problem can use the discount window to receive cash or its near equivalents from its Federal Reserve Bank. The logistical considerations of distributing a large number of bank notes throughout the branch network of a large bank would cause only minor inconvenience. There is no obvious reason why several such operations should not be carried out at once. Also, the money would probably be redeposited in the banking system almost immediately since the alternatives — holding large quantities of banknotes, or investing in other intermediaries or in securities directly — are riskier than putting money in a bank.

Nevertheless, the fact remains that such a series of retail bank runs might still hurt consumer confidence.

Concern about the US banking system also centers on the wholesale markets for bank paper, the commercial paper markets and the interbank market. If a major bank were to fail now, there is a risk that its debt to institutional investors — banks and nonbanks alike — would become illiquid and decline sharply in value. Of course, the Federal Reserve would intervene as it has in the past to provide liquidity in the interbank market. If necessary, it would absorb a part of the ultimate costs of price falls in both markets, in effect converting private illiquidity into public debt. But because it might not absorb all of the ultimate costs, institutional investors have good reason to be alert to bad news about specific banks' prospects. Institutional investors, who are relatively well informed and able to precipitate a crisis, are more likely than retail depositors to cause a major failure.

This general threat must increase borrowing costs in the interbank and commercial paper markets slightly. Were a major failure actually to occur, the cost of borrowing for banks, whether for short or long term, would be likely to rise substantially. Institutional investors would worry that the bank creditors of the original failing bank might fail also and would therefore cut back their claims on other similar banks.

This scenario has been a substantial concern of every US bank that has a below-average credit rating. To improve capital adequacy and to provision generously against future losses have, therefore, been especially high priorities going into the current recession.

Before the Basle agreement, US banks were permitted to add back their loan loss reserves in computing core capital. Although banks have had some years over which to phase in the new standards, the deduction of loan loss reserves from core capital has itself proven difficult for banks with troubled assets.

Given that the cost of capital has been high, banks have had little alternative but to curtail expansion and in some cases actually to shrink their loan portfolios. They may have had to turn away creditworthy businesses to prevent a further decline in their capital ratios. Hence, concerns about a credit crunch.

There are two reasons to doubt whether a credit crunch has in fact started. First, surveys of small business do not rank restricted access to credit as a particularly serious problem. Second, there was about $200 billion of Tier I capital in the US banking system at the end of the third quarter of 1990, whereas only $160 billion would have been needed to maintain an average capital ratio of 6%, given the outstanding level of assets at that time. Taking account of Tier II capital as well, there was more than enough capital to support a substantial expansion of lending in the near term by this standard. Still, there has been enough anecdotal evidence of a crunch to cause bank supervisors to take the problem seriously — to consult with the banking industry and encourage it not to tighten credit standards unduly, assuring the banks that federal bank examiners would not be overly zealous in forcing write-downs on new loans.

Whether or not a credit crunch has actually happened, it is easy to imagine how one could intensify the recession. Banks with below-average financial positions might turn away creditworthy clients. Such banks might be concentrated in particular regions having few strong institutions to pick up the business and, of course, strong out-of-state banks cannot generally help because of the prohibition on interstate banking. This reduces the comfort to be derived from the global statistics regarding the adequacy of capital in the system as a whole.

In addition, even the management of a bank from the same state with capital above the regulatory minimum might be reluctant to expand lending in this recession. Despite its better-than-average financial position, such a bank might still be constrained by costs from raising equity and feel it had to increase its capital ratios for two reasons. First, the market value of some of its assets may well be less than the book value, and it might want to build up a cushion against possible liquidations. Second, it might well set itself a standard for the ratio of capital to assets substantially above the historically adequate minimum of 6%. Banking is more competitive, and the value of a bank franchise, which formerly acted like goodwill in buttressing the financial condition of bank, has declined.

A Liquidity Trap? US short-term rates have fallen significantly since economic prospects started to weaken. Short-term rates fell about 50 basis points between April and November 1990 and have dropped another 100 basis points since then. Treasury bills are currently yielding about 6.2% while 30 year Treasury bonds are about 200 basis points higher: the yield curve is steeply positive.

It is possible that, if the Federal Reserve lowered interest rates further, the banking system may not be prepared to lend much more. Moreover, even creditworthy households and firms may not be prepared to borrow. Easier monetary policy may have no perceptible effect on demand, even accounting for a lag. The US authorities may be in a liquidity trap.

At first brush, this seems very unlikely. The experience of the past several decades is that lower interest rates stimulate nominal demand and, strict monetarist theory notwithstanding, real demand as well.

What may make current circumstances so exceptional is the distress in the banking system itself and the heavy indebtedness of the business and household sectors. It is quite plausible to argue that, even if a bank felt that the recession were bottoming out it would be extremely cautious about lending more. True, lower short-term interest rates that are not fully passed through to the customer could improve bank profits, raise stock prices and thereby lower the cost of capital. But banks still might not lend if management sees its top priority as rebuilding the bank's financial position and reducing the risk on its balance sheet. In this case, banks might still feel that the risk of new lending — and the cost (in terms of capital assigned) — outweigh the value of potential future income.

Equally, a household or a business that thinks a recovery is in sight might still be very reluctant to borrow to finance expansion or consumption. It might consider that the first order of business in any recovery would be to strengthen its balance sheet. So, if these attitudes were pervasive, measured confidence could improve, but spending might not increase as a result.

Japanese Banks. The situation in the Japanese banking system is, perhaps, less threatening. Japanese banks survived the stockmarket fall in 1990, which reduced the market capitalization of some major banks by two-thirds. Most credit ratings have been lowered. International capital adequacy standards and simple commercial prudence dictate a halt to their rapid rate of expansion. They now face risk from a potential sharp fall in real estate prices.

For the past several years, real estate prices in Japan, especially in Tokyo, have risen far faster than inflation, reflecting some combination of restricted supply and expanding demand on the one hand and speculative forces on the other. When the stock market corrected in 1990, real estate prices held up in most cities. But they appreciated less than they had in earlier years. The fear now is that, despite continued prospects for economic growth and generally high occupancy rates, real estate prices might tumble sometime soon.

The effect on the banking system would be both direct and indirect. Real estate assets remain on the books of the city banks, even though they have limited their direct investment in land and real estate development in the past two years. And many have lent funds to specialized real estate companies, some of which now seem to be in financial difficulty. Moreover, some of Japan's older commercial firms in which the banks have an interest have used their real estate holdings for collateral for loans that have financed speculative investments.

Japanese Real Estate. Finally, a possible fall in Japanese real estate prices would have a muted direct effect on consumer behavior since real estate is less widely owned in Japan than in the United States. But there is some evidence that Japanese savings could rise nonetheless as households that had recently given up their hopes of ever owning real estate reappraise their situation. These households have been cited as one factor in the expansion in Japan's strong domestic demand for the past two years. If they decide that, after all, it might be worth saving for a house or an apartment, the savings rate might rise and domestic demand slacken.

So, the possibility that financial fragility would have a direct impact on the short-term macroeconomic performance in Japan seems remote. It might however, erode confidence and spending if real estate prices tumbled and the quality of bank assets was hurt materially. And, despite the relatively small share of the population that owns real estate, such a fall might lead to lower consumption, regardless of its impact on the banking sector.

The US Public Sector Deficit

Large US public sector deficits of the past decade have created quite a different problem. Interest rates are probably higher worldwide today than they otherwise would be, because of the large federal debt that must be serviced in the United States. In addition, the deficit situation may contribute to lower domestic demand in the near term in two indirect ways. First, at the federal level, last year's budget proposals call for a decline in the federal deficit — net of both the thrift bailout and the effect of the recession — from about $170 billion in 1991 to $148 billion in 1992. This is a 0.4% decline in aggregate demand in a $5 trillion economy. Second, state and local governments have been planning expenditure cuts and layoffs for some time because of earlier budget stringency. These are now coming into effect in the thick of the recession, not at the tail end or during the early part of a recovery, as they usually do.

There is a third factor — the end of the Gulf War. Like the inventories issue discussed earlier, this has been the subject of much poorly argued commentary. On balance, it is not likely to add much to aggregate demand. In fact it may result in slightly lower demand, but the net effect is likely to be very small indeed.

Now that the war is over, the increased munitions and materiel production that went with mobilization will taper off. Restocking will be spread out over a long period. This limited stimulus, which presumably worked against the slide into recession in the fourth quarter of last year, will now end. Consumption from accrued income by troops returning home may offset this to some extent. But many reservists are coming back to uncertain job situations and are unlikely to spend freely.

Two further points are worth making about the federal deficit. First, there is unlikely to be any large cyclical impact on interest rates of the $318 billion federal budget deficit forecast for 1991. Therefore, any potential upward push on rates, net of the thrift bailout (which accounts for $111 billion), is offset by higher private saving and lower private investment and diluted by international capital flows.

Second, the savings and loan crisis is over, to all intents and purposes. Although it is still a matter of serious political concern in Washington, the poor investments that led so much of that industry into difficulties are sunk costs and the taxpayer payments to the depositors of failed institutions are, ultimately, just transfers. There is no real economic cost associated with the very large impact of the thrift bailout on the federal budget other than any unanticipated and undesired redistribution of wealth.

To see this, consider an individual who has a $10,000 deposit in a thrift that is so thoroughly bankrupt that the Savings Association Insurance Fund (SAIF) — formerly the Federal Savings and Loan Insurance Corporation — must pay all $10,000 to make him whole: his deposit has become, in effect, a claim on the US Treasury. To honor this claim, the Treasury may have to borrow $10,000 from the capital markets. Assuming this individual has not altered his consumption plans in the meantime, he must now take his $10,000 and invest it, either directly in the capital markets, or indirectly through another intermediary, such as a bank. In either case, what the US Treasury took out of the credit markets, he puts back in, and there is no reason why real or nominal interest rates should move as a result.

Is there a difference from a macroeconomic viewpoint between a thrift making good a deposit out of equity after a loan defaults and the Treasury making good when that equity has run out? Not really, for if the equity is to be made up it must be raised on the capital market. Of course, the cost of the two types of capital — thrift equity and Treasury debt — are greatly different, but in essence the equity issue constitutes a similar draw on savings that will be financed, indirectly, by the now-good deposit.

So this large component of the federal deficit has no real significance for the course of this business cycle. It is not crowding out private sector investment. It is not stimulating demand. But the program in place to lower the structural deficit does matter. It offsets the automatic stabilizers in fiscal policy to some extent. And state and local government cutbacks also matter since they have bitten earlier and deeper in this recession than is typical.

Uncertainty about International Financial Arrangements

For the past several months, Germany's fiscal and monetary policy mix has probably had an adverse effect on the other economies of the EMS.

A political decision was taken shortly after unification to finance the public sector costs of the reconstruction of East Germany through borrowing rather than through tax increases. This raised long-term interest rates. The expected real return to capital in Germany has risen — future large gains in productivity in East Germany are being discounted — and competition for funds has intensified. At the same time, to counter any inflationary tendency that might accompany this surge in demand, the Bundesbank has tightened monetary policy and raised short-term interest rates.

Recently, a major shift in German fiscal policy was announced: an income tax surcharge and a levy on gasoline sales would be charged beginning in the middle of the year to cover a large part of the fiscal costs of reconstruction. The deutsche mark is no longer the currency at the top of the EMS band. Now the peseta is strongest as a result of high Spanish interest rates, reflecting high inflation and a comparatively strong economy in Spain.

The effect for other members of the EMS has been to place a floor under their own real interest rates. In the United Kingdom in particular, which is working to establish the credibility of its commitment to the EMS, rates will have to be well above those elsewhere in Europe to compensate investors for the perceived risk that the United Kingdom may devalue after all at some point in the near future.

Since demand is weakening anyway in France and Italy, and the UK is in a recession, the export of high interest rates comes at a bad time. This is likely to contribute to weaker confidence and consumption and lower investment than there otherwise would have been in these economies.

But will these effects outweigh the increases in consumption and investment in Germany (and the secondary effects of Spain's economic strength), increasing demand for the exports of other European countries? That depends on how interest-sensitive demand is in Germany and in the rest of the EMS, and on the strength, timing and direction of any trade effects. But it also is a function of the size of the wedge between German and other EMS country interest rates. Three hundred and fifty basis points separated German and British three-month Euro-currency deposit rates early in 1991 and there was a 150 basis points spread between UK and German long-term government paper.

In addition to uncertainty in the capital markets about the UK commitment to its new international monetary arrangements, there may be some short-term inefficiencies connected with the program for European monetary integration. That program is proceeding apace, by historical standards of European institutional change, and it creates uncertainties about future exchange rates within the EMS — despite the fact that the eventual objective is to reduce currency risks to zero. The prospective terms on which, and the way in which, individual national currencies are eventually subsumed into a single European currency, have yet to be settled. This will have an increasingly important influence on exchange rates as the day approaches when a credible settlement is announced. Premiums for returns on assets denominated in the weaker currencies are likely to be greater now than they would be without this uncertainty.

A second macroeconomic problem related to international financial arrangements is the uncertain course of the dollar. It fell roughly 10% in value between the first and third quarters of 1990. It is has recently enjoyed a strong rally — associated both with the widely held view in international financial markets that the worst of the US recession is over and with concern over stability in the Soviet Union — but it remains in the lower half of its trading range of the past two years.

It appears at the moment that there is limited policy coordination within the G-7 with regard to currencies. In late January the US discount rate was lowered almost simultaneously with an increase in Germany's Lombard rate. The monetary authorities were willing to intervene in concert — which they subsequently did first to support and then to restrain the dollar — but it seemed at that time that interest rate policies were being driven primarily by domestic considerations with little heed for their effects on exchange rates.

In the current context, such uncertainties in the foreign exchange and capital markets constrain Federal Reserve monetary policy and could exacerbate the US downturn. For, before the Federal Reserve eases monetary policy for domestic countercyclical reasons, it must weigh the potentially disruptive effect abroad of lower interest rates on the dollar. Were the dollar supported by a more credible joint G-7 stance, this consideration would fade in significance.

So uncertainties about international financial arrangements could contribute to deepening economic difficulties both within the EMS and with regard to the dollar.

Stagflation

The second risk facing the world economy in the near term is that inflation resumes its upward trend and output stagnates. Since concern over a possible oil price shock has faded, it seems unlikely that inflation will accelerate rapidly. The scenario of relatively little growth, say under 1% a year, and inflation that resumes its disconcerting upward drift, say from 5% to 6 or 6.5% over the next two years, seems more probable.

In the wake of a short and shallow recession in the United States, and after France, Italy and the United Kingdom recover in Europe, inflationary pressures might intensify worldwide. Yet the recovery might be very weak. Monetary policy might be tight enough to stifle much growth — continuously, or in fits and starts — without curbing inflation significantly.

Core inflation drifted upward in the industrial countries between 1987 and 1990 from about 4% to 5% a year. These figures may even overstate the true rate of price increase because quality improvements in services and some manufactured goods are probably understated in national output statistics, so that price increases do not reflect inflation so much as the delivery of more "good" or value per unit of sales. The US Commerce Department estimates that this effect could have led to an overstatement of US inflation by as much as 1% in recent years. If this were generally so, the true rate of inflation in the recent trough may have been about 3% and the rate at the end of 1990 may have been about 4% for the industrial countries as a group.

This is not an alarming level in and of itself — accounting for such a modest rate of inflation does not create any particular management inefficiencies in resource allocation — yet, the upward drift is cause for concern.

Where did this drift originate in the late 1980s? First, wholesale prices spurted upward in 1987 — particularly food and energy prices. As that fed through to final consumer prices in late 1987 and 1988, monetary policy was quite expansionary in the wake of the 1987 stock market crash and growth was strong. Thereafter, labor market conditions tightened — vacancy rates rose and unemployment rates fell — to a point where unit labor costs began to rise in 1989 and 1990. Nonwage compensation was accelerating. Monetary policy was tightened in most OECD countries in 1988 and 1989, but with little effect initially, and the drift upward in consumer prices continued, particularly in services, even before the oil shock. Although the average unemployment rate had fallen to only about 6% in 1990, these broad trends suggest that the industrial country economies were overheating somewhat when the oil shock struck.

In the recent period since the oil shock of mid-1990, indirect evidence shows that inflationary expectations did not lunge upward, which is a positive aspect of the current situation. Yet, if this upward drift were to resume in a recovery, there is every chance that expectations would begin to move ahead too.

Why should this danger be at all acute? Four reasons come to mind.

Price Pressures in Germany

First, strong price pressures are emerging in Germany. In the East, organized labor has been pushing for higher wages in advance of productivity gains to win converts and, not unintentionally, to protect the living standards of West German unionized workers. In the West, labor demands are increasing as a result of strong profit performance throughout industry.

While recessionary tendencies persist elsewhere on the continent and the United Kingdom remains in a recession, it is unlikely that Germany will export higher inflation to the rest of EMS. But, if higher German inflation persisted into a general European recovery, then it might create an umbrella under which prices and wages could resume their upward drift elsewhere in Europe.

Of course, the tax increases that were recently announced for mid-year should dampen domestic demand and reduce pressure on German interest rates and prices. The effect of the proposed direct surtax on gasoline on measured consumer prices is easily allowed for, and the temporary nature of this and the proposed surcharge on income tax undermines the case that labor might make for a compensatory increase in wages.

But, more fundamentally, the Bundesbank has made it clear by its statements and actions that it will not let this inflation get out of hand. Indeed, the firmness of its stand was an important factor behind the tax increase, without which the risk of German price pressures fueling post-recessionary inflation would be significant. Given the active determination of the Bundesbank and its high credibility, the risk of any sustained upward creep in German prices is minimal.

A Monetary Dilemma in the United States

The situation in the United States might be more difficult. For, in a mild recovery, the Federal Reserve would continue to face a dilemma.

While it might like to tighten monetary policy enough to keep downward pressure on the core rate of inflation, it would still have to nurture a fragile financial system back to health. Many of the problems that might contribute to a severe recession in the near term would remain latent. So monetary policy might well be sufficiently accommodating to allow service sector inflation to resume. In particular, if medical costs continue to rise unchecked, this could feed generally into the nonwage component of compensation packages and cause labor costs to accelerate ahead of productivity throughout the economy.

The need for the Federal Reserve, in certain situations, to balance the health of the banking system against an objective of strict inflationary restraint is understood in the financial markets. It means that the Federal Reserve faces a greater danger of losing its credibility where its anti-inflationary stance is concerned, if for a moment it is seen to compromise. Other industrial country central banks with healthier banking systems are in an enviably straightforward position by comparison.

The Inherent Uncertainties of Monetary Policy

A third possibility is that monetary policy would be too easy early in the recovery and that its stimulative effect would linger on, encouraging price inflation and having a diminished effect on output as the industrial economies approached capacity.

Why might this happen? The fact is, it may be difficult to read developments immediately after an initial fall in short-term interest rates. There is the possibility of a liquidity trap in the United States. But in other industrial countries there might be a similar reluctance to increase lending or borrowing to begin a recovery. The rise in private debt to GNP ratios was not just a US phenomenon in the 1980s. Perhaps even lower interest rates would be needed.

If central banks misinterpret a lag in the response of the economy to lower interest rates as a sign a continued weakness, they might lower rates too much and overstimulate the industrial country economies. In other words, if the recession is quite typical, but a bit deeper than the "short and shallow" one that is generally expected, the central banks might overreact.

A US Debt Crisis

The final possibility that should be mentioned is that the deterioration in the net investment position of the United States in the 1980s comes home to roost. This could lead to an inflationary shock in the United States rather than the gradual rise in inflation rates discussed in the previous three sections.

In the middle of the decade, several international economists constructed a powerful case for thinking that a disastrous dollar collapse could occur. They thought that the United States had been able to borrow so heavily only because the international investor community had confidence in US government promises to reduce the federal deficit. Investors expected this to raise US savings rates, lower consumption as a share of GNP and correct the external balance in due course. The economists, however, expected that the federal government would renege repeatedly on its promise, investor confidence would wane and at some point capital would fly, driving down the dollar so far and driving interest rates so high as to cause an economic collapse.

This has not happened yet. In fact, during 1990, the dollar made a relatively orderly retreat to historic lows against the deutsche mark and no disastrous episode of capital flight occurred. Perhaps the fact that the dollar remains quite low reduces the chances of further declines. As we noted earlier, nominal interest rate differentials suggest that the markets expect the dollar to appreciate from its current levels. Perhaps the simple fact is that the US economy is so huge that it can service a large net foreign capital obligation with relative ease.

But the fact that economic collapse has not happened yet does not mean that it could not. There are enough liquid, internationally mobile investments to finance a short and calamitous capital flight episode. And, given that most international investor assets in the US are dollar denominated and that the United States controls the supply of dollars, foreign investors have grounds to eye US macroeconomic policy more warily than, for example, they eyed Mexican policies in the early 1980s.

Were there to be a sharp decline in the dollar, its effect would be most uncertain. If it did threaten serious consequences for US economic activity — which would seem likely — it might be difficult for the Federal Reserve to meet those demands and to counter the inflationary shock of higher import prices at the same time. Inflation and inflationary expectations might, indeed, move upward.

What are the costs of an upward drift in inflation rates and why should it be feared? The answer is that, at a certain point, inflation creates so much uncertainty that all kinds of economic decision making are hampered and, when there is a steady upward drift, that point will eventually be reached. It is expensive in terms of output foregone to reduce the inflation rate or to check an upward trend. Roughly speaking, to lower it by 1% in the United States, the economy has to run 4% below capacity for a year. So there is a great deal to be said for keeping inflation in check from the outset.

Policy Recommendations

How, then, should the governments of the industrial countries meet the risks of a deep recession on the one hand and of a stagflationary recovery on the other?

Managing Confidence and Debt

At some point in a normal recession, investment, external demand and consumption respond to interest and exchange rate changes; public spending rises; and expectations and confidence improve in parallel. In our gloomy scenario, confidence is held back by the debt burden accumulated in the 1980s and by the recent decline in asset values. Even where it does strengthen, it is not associated with much additional spending by businesses or households because they prefer to use extra income to pay down debt. Instead of the normal amplifying effect that consumption and business investment have when, say, increased exports raise business and household income, such an external stimulus would be muffled and absorbed by households that have a low propensity to spend.

It is extremely difficult to think of original policies that can encourage spending among the newly prudent. If a household has undergone a fundamental change in attitudes toward debt — and such changes may have been widespread in the past two years — it is difficult to think of anything short of an unexpected inheritance or a lottery prize that could bring back the ways of free spending and borrowing — hardly an applicable approach to national policies.

In these circumstances, the Study Group can only say that, if the present recession is mild and short, this close brush with something more serious should be taken as a warning. Tax and expenditure policies should be reviewed more earnestly than they have been in the past to see what can be done to encourage savings rates and the average ratios of equity to debt to rise — gradually. That would create a stronger basis for consumer and business confidence and future recessions would, therefore, be far less threatening.

Countering Financial Shocks

From a macroeconomic perspective, financial shocks are an easier subject than confidence. The Study Group wishes to underline the importance it attaches to responding quickly to contain financial shocks. This is unlikely to be a controversial position.

However, emergency liquidity to a particular institution should not be allowed to become a general increase of the money supply. It is important that any temporary general increase that results from rescue operations for any particular institution or market be drained promptly from the system through appropriate open market operations.

One cannot be categorical about the "promptness" of draining operations when there is doubt about the extent of financial distress. If financial fragility became acute, it would seem prudent to err on the side of putting excess liquidity into the financial system, as the authorities did in late 1987, rather than to risk the spread of financial distress. But the general principle still stands.

Don't Overburden Central Banks

If the recession does deepen, the regulatory authorities, particularly in the United Kingdom and the United States, may be faced with the failure of a major bank, and possibly more than one may become seriously financially distressed. It is desirable that the regulatory authorities should anticipate such situations and take preventive measures such as encouraging mergers, where these offer sufficient economies of scale or synergies to provide the prospect of future financial viability and strength.

This may well mean injecting money from the insurance funds, and ultimately from the public purse, into the banking industry. Undesirable as it may be to contemplate such an open-ended commitment of public resources, it is important that this commitment should be unqualified in the short term. In the United States, it would do no harm to reemphasize that the US Treasury is fully committed to dealing directly with the failure of any major institution or market during this period when the

Bank Insurance Fund is being drawn down and before arrangements for its recapitalization are put in place.

Moreover, the Federal Reserve should not be expected to compromise on its monetary objectives to reduce the risk of such a draw on the US Treasury. That would be requiring too much of a central bank and would risk compromising the credibility of its long-term goal of lowering inflation.

Financial Sector Regulation

Questions of the appropriate strategy for the evolution of the financial sector, in the United States and elsewhere, go well beyond the scope of this paper. However, from the perspective of their potential impact on the industrial country economies in the short term, the key consideration is that creditworthy borrowers have access to credit.

If the traditional channels of bank credit are impeded to the point where they place a significant constraint on borrowing, some questions need to be posed urgently. What can be done to refine loan appraisal techniques to counter possible excessive conservatism by loan officers? Can examiners signal that they would welcome prudent new lending? Should other channels of credit be opened up? Should government play any other temporary, extended role in supporting particular types of lending?

There has been some discussion of whether the phase-in of new international capital adequacy standards should be slowed. Our analysis suggests that, while capital ratios may be playing a part in the credit crunch, minimum standards are not the only issue. Rather, some stronger institutions may be intentionally adopting conservative lending strategies to improve their capital positions. On balance, the Study Group is of the view that not much would be gained by delaying the phase-in — and much that has taken a great deal of international effort to agree might be jeopardized.

Controlling Inflation

The Study Group endorses the idea that the first priority of monetary policy should be to prevent upward inflationary drift. This is the effect of pursuing eventual price stability over the medium term, which is a common guiding principle of most industrial country central banks.

It is also well understood how important constancy in policy is in the establishment and maintenance of credibility — both in the financial markets and more broadly in containing inflationary expectations throughout each national economy. The response to the 1990 oil shock demonstrated this.

There may be times, as we have argued, when uncertainty about the effect of monetary policy makes it prudent to err on the side of easing. These times, however, should be kept as infrequent and as short as possible so that the fundamental commitment of the monetary authorities on inflation cannot be questioned.

In the United Kingdom, this means the discomfort caused by the commitment to the EMS should probably be tolerated. In Germany, the Bundesbank must keep to its firm policy of containing the price pressures that have arisen from the reunification program. And, in the United States, as soon as the Federal Reserve is confident that the recession has reached bottom, it should put the continued control of core inflation ahead of stimulating a vigorous recovery in its priorities.

Coordination

From the imperative to control inflation, it does not always follow that domestic monetary policies will evolve in a manner that keeps exchange rates stable. Nonetheless, there is still great value in coordinating the implementation of policies and in communicating the fact of that coordination to the markets. This is particularly so when international financial arrangements are in flux, as they now are. This is a time when currency markets, and other international capital markets for that matter, are likely to be more volatile than usual and when that volatility, by inhibiting investment, may carry an especially high price either by restraining a recovery or by stimulating inflationary pressures after a recovery begins. And it may, as we have argued, also act as an undue restraint on domestically oriented policies.

A More Responsive Fiscal Policy

For political and institutional reasons, most industrial country governments find it very difficult to fine tune fiscal policy. This is true to such a degree that the idea of countercyclical fiscal policy has been abandoned in many policy-making and academic circles. In addition, there are sufficient doubts about the timing and scale of the effects of fiscal stimuli to make it seem a rather low priority to tackle the enormous task of removing the practical constraints.

Still, three points are worth making. First, Germany has managed to introduce temporary taxes and thereby balance its fiscal and monetary policies more sensibly. It is not impossible to adapt fiscal policies quickly. This may be an example worth studying.

Second, by doing so, Germany has reduced — though not eliminated — the strains in international financial arrangements. Perhaps other countries could reciprocate by temporarily cutting taxes. Were such flexibility to be developed in the future, it might in time provide a firm and increasingly balanced basis for international cooperation on exchange rate stabilization.

And, third, our analysis has suggested that a liquidity trap might arise, particularly in the United States, rendering monetary policy impotent to stimulate the economy out of recession. It would seem to follow that the appropriate response would be to adjust fiscal policy to provide an additional stimulus to the economy. But, we note that in the US in particular such a course would carry serious risks of its own.

Still, these are all reasons for raising — slightly — our assessment of the potential role of fiscal policy in demand management.

A Footnote on GATT

Finally, there is a long list of policy issues that received less attention than they deserved during the Gulf Crisis. In the international arena, the transformation of Eastern Europe, the dislocation of the Soviet Union and the future of European monetary integration are all receiving renewed attention.

From an economic viewpoint, however, the resumption of the Uruguay Round of multinational trade negotiations under the auspices of the General Agreement on Tariffs and Trade (GATT) is particularly important. No possible outcome could have much direct effect on the economic outlook in the next eighteen months or so, but a substantive agreement would hold out the promise of better long-term growth prospects worldwide. And, albeit to a slight degree, those prospects would be a sound basis for increasing confidence in the overall economic outlook, something that could indeed be critical in the next eighteen months.

Conclusions

The short-term economic outlook of the industrial economies recently deteriorated and recovered. Fears of an oil shortage or a third OPEC crisis are a thing of the past — albeit only six months into the past. Hopefully, the recession in the Anglo-Saxon economies will soon end and recovery begin, as is, at the time of writing, widely expected.

However, the world economy does face potentially grave risks. We have examined these, with a view to understanding how they might arise and what policy measures might be taken to counteract or ameliorate their effects. And, with the exception of an intractable and sustained decline in confidence rooted in debt and asset value problems, we conclude that there are few risks that sound policies cannot manage.

As we noted in the introduction, if events turn out as favorably as is now hoped, the fundamental problems that underlie the risks discussed here will still have to be addressed in due course. If, however, the world economic outlook deteriorates once more, these policy challenges could become urgent.

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Financing Eastern Europe

A Study Group Report

Richard A. Debs
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Table of Contents

Study Group Members and Participants vii

Acknowledgments xi

1. Introduction 1
Background 2
The Study Group's Work 3
The Report's Approach 6
The Importance of Eastern Europe 7

2. The Transformation of the Region 9
Recent Macro-Economic Performance 9
The External Sector 13
Structural Change 19
Stabilization 36
Ameliorating the Costs 38
Progress to Date 39
Prospects 41

3. Financing the Transformation 45
The Analytical Approach 46
Reform and Growth 47
Assessing Trade Prospects 52
Financing Sources 55
The Overall Outlook in the Baseline Scenario 87
The Sensitivity of the Baseline 90
Accelerating the Transformation: A Second Scenario 93

4. **Summary and Conclusions** 99
Domestic Stabilization and Adjustment 100
Rapid Implementation 101
Fundamental Shifts 101
Realistic Expectations 102
Specific Adjustments 103
Financing the Transformation 105
Possible Scenarios 107
Availability of Financing 108
External Responsibilities 111
The Need for Quick Action 111

Boxes

1. Appropriate Financial Systems 28
2. Releasing Private Sector Energies 35
3. Hungary's Social Security System 40
4. The CFSR's Program Ahead 42
5. Oil 50
6. Agricultural Trade 53
7. Export Finance for the Region 57
8. The IFC's Program 64
9. The Multilateral Institutions: Using Their Guarantee Authority 66
10. The Ecological Legacy 71
11. Sara Lee 74
12. PepsiCo's Lessons 76
13. Prospects in the Auto Industry 80

Text Tables

1. Recent Macro-Economic Performance in Eastern Europe 11
2. Domestic Resource Mobilization 13
3. Convertible Currency External Debt in 1990 15
4. Change in the Terms of Trade for Eastern Europe 17
5. Structural Reform in Eastern Europe 20
6. Financial Sector Reform in Eastern Europe 24
7. Baseline Scenario for Growth Abroad 49
8. Baseline Scenario for Regional Growth 51
9. Baseline Scenario for Trade 54
10. Baseline Scenario for Financing Sources 58

11. Baseline Scenario for Private Sector Financing 60
12. Debt Financing in International Capital Markets 65
13. Rules Governing Direct Foreign Investment 72
14. Direct Foreign Investment Intentions 75
15. Western Joint Ventures 79
16. Baseline Scenario for Official Financing 82
17. G-24 Commitments in 1990 83
18. Baseline Scenario for the Region's Net Investment Position 87
19. Baseline Scenario for Financing Uses 88
20. Baseline Scenario for Regional Financial Flows 91
21. Sensitivity of the Baseline Scenario: The Example of Poland 92
22. Accelerated Reform Scenario for Growth Prospects 95
23. Accelerated Reform Scenario for Long-Term Financing Prospects 96
24. Accelerated Reform Scenario for Regional Financial Flows 97

Annexes

Annex 1: The Quantitative Analysis 113

Annex Tables

1. Direction of Trade in the Region in 1989 118
2. Bulgaria: Sources and Uses of External Funds 120
3. Bulgaria: Net Investment Position 121
4. CSFR: Sources and Uses of External Funds 122
5. CSFR: Net Investment Position 123
6. Hungary: Sources and Uses of External Funds 124
7. Hungary: Net Investment Position 125
8. Poland: Sources and Uses of External Funds 126
9. Poland: Net Investment Position 127
10. Romania: Sources and Uses of External Funds 128
11. Romania: Net Investment Position 129
12. Yugoslavia: Sources and Uses of External Funds 130
13. Yugoslavia: Net Investment Position 131
Annex 2: Doing Business in Eastern Europe 133
Annex 3: Summary and Conclusions in Czech 149
Annex 4: Summary and Conclusions in Hungarian 167
Annex 5: Summary and Conclusions in Polish 185

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1. Introduction

The last decade of this century began with great hopes and great expectations for the peoples of Eastern Europe. The Iron Curtain that had separated East from West for so many years had been lifted, and the winds of freedom and democracy had begun to sweep through the region. The political forces for change had been set in motion and appeared to be irreversible.

The same forces seemed certain to drive economic change, for it had become obvious that the economic systems that had prevailed under the previous regimes had failed to deliver the benefits promised, and that economic reform was essential to the survival of the emergent democracies. It was also clear that the direction of economic reform was toward a free-market system. What was unclear was how to get there.

From the earliest days of 1990, much attention and study was directed to this question.

Two of the factors determining the pace and sustainability of the economic transformation are how much external capital will be required and to what extent it may be forthcoming. These were not easy questions to frame, let alone answer. Yet they were crucial. The rest of the world, while jubilantly welcoming the political changes and wanting to encourage and support the economic reforms necessary to ensure the permanence of those changes, had little idea of what demands the changes might make on Western economies. Nor did the leaders of the reform movements in Eastern Europe have a good grasp of the kinds or magnitudes of external finance they might need, or where it might come from.

Background

In the spring of 1990, the Group of Thirty concluded that it would be valuable to form a Study Group to focus on these questions. Although much work was proceeding on internal reform programs within Eastern Europe, there was a need to focus on the potential external financing needs of each country in the area and, just as important, to focus on every potential funding source — public and private, worldwide — that might be available, and then to analyze the conditions under which those needs might arise and be met.

Accordingly, a Study Group was established, comprising individuals whose expertise and experience directly related to the questions at hand, and whose judgments would influence the policy issues resulting therefrom. The participants represent a wide geographical spectrum, from the Soviet Union to the United States to Japan, and include government officials, officers of major multilateral institutions, academicians, and banking and business leaders from the private sector. As has been the practice with similar Group of Thirty study groups, each participant served in his or her personal capacity, and not as an official, for those who hold public office, nor as a representative of a company or institution, for those in the private sector. The opinions expressed in this report reflect a general consensus of the participants' views, but in any particular case are not necessarily the views of an individual participant.

A Secretariat for the Study Group was formed, led by Charles Taylor, Executive Director of the Group of Thirty, and Dr. Harvey Shapiro, a Senior Associate at the Carnegie Endowment for International Peace. Dr. Shapiro had recently retired from the US Treasury, where he was Deputy Director of the Office of East-West Economic Policy.

The Group was organized in July 1990 and held its first plenary meeting on August 1. The participants decided at that time to focus on the six core countries of Eastern Europe: Bulgaria, the Czech and Slovak Republic (CSFR), Hungary, Poland, Romania and Yugoslavia. Believing that at some early point the Federal Republic of Germany would be united with the German Democratic Republic (GDR), the Study Group decided not to include the GDR in the core group, but to keep it in mind as a point of reference in the reform process, as another destination for financing and as a trade partner of the other countries of Eastern Europe.

The Study Group also decided not to include the Soviet Union as a specific case, primarily because of the uncertainties the Group foresaw with respect to its financing needs. How the financial role of the republics would develop was — and continues to be — unclear. Nonetheless, the Group did pay attention to the Soviet Union as the chief trading partner of the East European countries.

At the time of the Study Group's first meeting, it was clear that the Soviet Union would change the terms of its trading arrangements with the region to require settlement in hard currencies at world market prices early in 1991. Because oil was one of the major Soviet imports into all of the East European countries, it was also apparent that such a change would hurt the economic prospects of Eastern Europe.

The Study Group's Work

On the day after that first meeting, Iraq invaded Kuwait. In the weeks that followed, the price of crude oil — a crucial import for Eastern Europe — doubled, and the conflict in the Gulf aggravated an economic downturn in the United States and the United Kingdom. In Germany, the problems of reunification became a preoccupation, with higher costs and slower progress than originally anticipated. Worldwide, commercial banks were under continuing pressure as earnings fell and capital requirements rose, undermining their ability to increase lending. In addition, the breakdown of the Uruguay Round was a most discouraging development for world trade, in general, and did not augur well for the East-West trade growth that is so important to Eastern Europe. Expectations about economic and political progress in the Soviet Union deteriorated.

Against this background of disheartening worldwide developments, all beyond the control of the East European countries themselves, the Study Group conducted its analysis and assessment. The first step was a study, undertaken by the Secretariat, to gauge the orders of magnitude of the external financing needs of each East European country over the next several years. These orders of magnitude were based on projections of current account balances; estimates of official financial flows; and estimates of possible future flows of private funds, including commercial bank lending, capital market flows and foreign direct investment.

The Study Group realized that conditions had changed so dramatically in Eastern Europe and were subject to such continuing rapid change, that extrapolations based on previous trends and experiences were extremely difficult to make with any sense of comfort. Although the discontinuity with the recent past in Eastern Europe jeopardizes any attempt to project a trend into the future, the analysis proved useful, especially inasmuch as it was buttressed by the judgments and views of the members of the Study Group. Together, they brought a unique perspective to this problem.

The Study Group recognized that it could not successfully complete its mission by focusing exclusively on external finance, and that it had to consider in some depth the internal domestic reform programs in each country. External finance would be only one of many factors that would affect the economic results of the reform programs; other influences, such as the mobilization and use of domestic resources, internal market restructuring and domestic stabilization packages, would also be important. These domestic factors, which would determine the economies' absorptive capacity, would in turn critically influence the magnitude, nature and timing of external financing requirements and availabilities.

The Study Group therefore reviewed each country's internal reform program, and the analyses are set forth in the body of this report. In addition, Annex 2 summarizes the current business conditions in each of these countries. The summary is intended to serve as a reference, with the caveat that it may soon become outdated by the pace of developments in the region.

The potential sources of external finance are many. During the course of the study, an in-depth review of every possible source of external finance was made, both private and official. This review focused not only on potential financing but also the conditions under which it might be provided. For, in general, the potential availability depends in great measure on progress in the region's reform programs, which will determine each country's absorptive capacity — its ability to utilize such funding effectively and productively.

This was particularly relevant — indeed critical — in looking at the sources of private sector funding. The Study Group reviewed all possible sources, including commercial bank lending, ranging from trade finance to project finance; capital market flows, including bond issues, equity issues, portfolio investment and country funds; and foreign direct investment. In all cases, the potential depended directly on the progress of reform within the countries involved. The Study Group observed that, despite the strong policy reasons for considering *official* financial support for these countries even if their reform programs faltered, there was no reason whatsoever for *private* capital to flow to the region unless the economic, political and legal environment would protect loans and investments and allow rates of return commensurate with the risks entailed.

Consequently, private sector flows may differ significantly, in both magnitude and kind, from official flows. Yet it is crucial that the East European economies attract private sector finance, particularly equity investment, not just for the foreign exchange provided but, even more important, for the contributions they can make in the development of free-market economies. Foreign direct investment brings with it qualitative benefits that are particularly relevant to these economies as they move towards freer market systems. The conclusions of the Study Group with respect to external financing flows are set forth in detail in Chapter 3.

The Study Group's conclusions on the central question of internal reform programs and the availability of external financing are set forth at length in the body of this report. At the most general level, the Group concluded that every effort should be made to accelerate the pace of reform. Faster reform should be accompanied by more official assistance in the next two or three years and should hasten the day when significant amounts of private financing begin to flow into the region.

At the risk of generalizing, a gradualist approach is unlikely to yield the best results, which are more likely to emerge from an expeditious and comprehensive program, designed to go forward on all fronts as rapidly as feasible. Although they may entail serious short-term disruptions, such accelerated programs have the best chance of achieving their objectives.

The Report's Approach

This report addresses two central questions: what amounts and forms of financing, in what circumstances and subject to what conditions, will be needed and effective in supporting the reform programs; and what amounts and forms of such financing are likely to be forthcoming.

To address the issues of external finance, the report initially focuses on the national reform programs themselves. Chapter 2 sets out the Study Group's assessment of those programs, providing the groundwork for gauging the likely needs and matching them against the possible sources and scale of external finance and assistance, which is the subject of Chapter 3.

The assessment is based on two illustrative, quantitative scenarios that extend to 1995. The first outlines how the region's economies might progress if the current momentum of reform were maintained on its present course. This "baseline" scenario incorporates current indications of official finance, the Study Group's own assessment of likely private financial flows as well as several economic assumptions about the outlook in the region. This scenario suggests that real economic growth might resume in the region only after a rather lengthy period of contraction, during which the burden of domestic dislocations and the adverse external environment would outweigh the initial benefits of reform.

Because such protracted economic hardship might undermine public acceptance of the costs of reform, other scenarios were tested, based on different assumptions and hypotheses. An alternative scenario was selected, based on the assumptions of accelerated domestic reforms, increased economic efficiency earlier on, and improved domestic resource mobilization and allocation. Accelerated reform should increase absorptive capacity for external financing and, although it would increase financing needs at the same time, should also attract more official support from abroad and private sector financial inflows. Because of these associated effects, the gains — in terms of faster growth and increased foreign financing — accompanying accelerated reform could be substantial.

Finally, Chapter 4 lays out the main implications for economic policy, both within the region and for the industrial countries' governments.

The Importance of Eastern Europe

In reviewing its work, the Study Group was pleased to note that external financing flows and commitments to Eastern Europe have exceeded estimates made a year ago, despite the fact that the economic environment in the rest of the world has generally deteriorated since then. The industrial countries, especially in Western Europe, have a key interest in seeing the region through this difficult period.[1] They stand to gain from future trade, if the transformation succeeds. They stand to lose from cross-border effects — migration, pollution and, conceivably, increased security expenditures — if reform stagnates or goes into reverse. Perhaps most important, the concept of market-based democracy is on trial, and how it fares in Eastern Europe will influence attitudes worldwide toward the industrial countries' approach to governance.

The Study Group reaffirms its belief that the recent changes in Eastern Europe are a most welcome development for the world as a whole. The trend toward democracy and free markets must receive the support and encouragement of the rest of the world. Every effort should be made to ensure that the necessary external capital, in adequate amounts, at appropriate times and for the most efficient uses, will be available to support the reform programs as they proceed.

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[1] *Throughout this report, "industrial countries" is the expression used to refer to the members of the Organization for Economic Cooperation and Development (OECD), that is, the countries of Western Europe, North America and Australasia, plus Japan.*

2. The Transformation of the Region

The regional transformation currently underway is fundamental. Under the old system, the state set the terms and determined the nature of almost every economic transaction and was a party to them. Now the countries of Eastern Europe are working toward a new system where the principal locus of economic activity will be between individuals and among private enterprises.

At one level, the objective is to improve the efficiency with which scarce resources are allocated among competing uses. At a more profound level, the aim is to give individuals freedom of choice as customers, clients and consumers and, in their capacity as producers, to give them the responsibility for making goods or providing services that others will value and purchase.

This transformation is taking place in some respects at an inauspicious time. Recent macro-economic performance has been weak; heavy external debt handicaps three countries of the region; the volume and terms of trade with the Soviet Union have deteriorated sharply for all of them; and the Gulf War has disrupted trade with Middle Eastern countries.

Recent Macro-Economic Performance

In the past, efforts to analyze economic developments in Eastern Europe were hindered greatly by inadequate information. Statistics on foreign exchange reserves were considered state secrets. Net material product, the central planning equivalent of gross national product

(GNP), excluded the service sector. Inflation was disguised when, as was often the case, bureaucratically set prices remained stable despite endemic shortages that would have forced prices to rise in a more open economic regime. The length of waiting lines became a proxy for price pressures.

Statistical problems persist despite the systemic movement toward freer markets. In Poland, for example, industrial production reportedly fell 30 percent in 1990. But the data are based on state sector performance and do not reflect the boom that occurred in the admittedly small private sector economy. Moreover, 1989 output may have been inflated by some state sector managers reporting excess output, and the 1990 figures may have been under-reported to minimize future tax obligations.

Table 1, which summarizes recent economic performance, should therefore be taken with a pinch of salt. But it does serve to make two points. First, there are significant differences among the countries of the region. This is a point which should not be forgotten in the subsequent discussion of issues facing the region as a whole. Although all the countries of the region face a transformation that is similar in kind, they are at different stages and pursuing different strategies and face different external and historical circumstances.

Second, notwithstanding these differences, Table 1 does suggest that growth was modest throughout the region for the past decade, and that there were absolute declines in economic activity in every country in the last two years.

In *Poland*, the *CSFR* and *Hungary*, the recent downturn largely reflects the economic dislocation caused by reform. Declining GNP in *Yugoslavia* is accounted for largely by political problems. Strife between the republics, for example, has caused Serbia to impose tariffs on goods from Croatia and Slovenia. In *Romania*, the Ceausescu regime ended with a complete political and economic breakdown. The 1990 decline in *Bulgaria's* GNP reflected a bad harvest, domestic turbulence and disruptions in trade with the Middle East and the Soviet Union. Indeed, trade problems have been a negative influence on growth for the entire region. The *CSFR's* GNP did not decline in 1989, perhaps because it is relatively open to trade from the industrial countries, and because it did not begin

Table 1. Recent Macro-Economic Performance in Eastern Europe

	Bulgaria	*CSFR*	*Hungary*	*Poland*	*Romania*	*Yugoslavia*
Real GNP Growth[a, b]						
1981-1985	0.3	1.3	0.5	1.8	1.0	1.3
1986-1988	1.6	1.7	1.6	0.8	1.5	1.1
1989	-0.1	1.0	-1.3	-1.6	-1.5	-1.0
1990	-11.0	-3.0	-2.0	-13.0	-10.0	-6.0
Inflation (%)						
1986	2.6	0.0	4.2	21.0	4.7	88.3
1987	1.7	0.9	9.3	28.5	3.0	118.3
1988	3.4	0.9	15.2	70.0	2.2	185.3
1989	11.4	1.8	16.9	640.0	4.2	2,795.6
1990[c]	60.0	10.0	30.0	250.0	10.0	130.0
Memo Items[d]						
Life Expectancy (years)	71.0	72.0	69.0	70.0	70.0	72.0
Population (millions)	9.0	15.6	10.6	37.8	23.2	23.7
Population Growth (annual percentage 1980-88)	0.2	0.2	-0.1	0.6	0.5	0.7

a. Average annual rates.
b. 1990 data are estimates
c. The Romanian data apply only to officially monitored prices in the first nine months.
d. Life Expectancy and Population are 1989 data.
Source: Handbook of Economic Statistics, 1990, US Government Printing Office, September 1990.

to implement major economic reforms until 1991.

Table 1 also suggests that inflation was modest — or, more probably, disguised by price controls — for most of the past five years. Certainly, *Poland* and *Yugoslavia* experienced hyper-inflation in 1988 and 1989; in 1990, both countries adopted reform packages that stabilized prices. In Poland's case, the reforms were wide-ranging and fundamental — setting controls on the net domestic assets of the banking system and on credit extension to the government and opening the economy to external competition, among other things — and promising more stable prices in the future. In Yugoslavia's case, the fundamental reforms that were to accompany a freeze in prices and wages were not introduced successfully, and inflation accelerated again in the second half of the year.

One more point about past economic performance deserves emphasis: Eastern Europe has used all its resources inefficiently and, as a result, savings and investment rates have been high in relation to economic growth rates.

Historical rates of savings and investment in the region are not low by international standards (Table 2). They should not constrain future growth, if they hold up. Savings rates might decline if more open access to the consumer goods markets of industrial countries increased household spending. Or the rates might rise if uncertainty created by reforms caused private precautionary savings to increase. Equally, public sector saving could rise as a result of fiscal reforms and the privatization or liquidation of loss-making state-owned enterprises.

More remarkable than the savings and investment rates of the past ten years is the inefficiency with which saved resources have been put to work. This is reflected in the incremental capital-output ratios (ICORs), which measure the increase in capital (the investment in an economy) as a fraction of the increase in economic activity (GNP). ICORs are high when capital is used inefficiently and low when it is allocated well. Eastern Europe's high ICORs in the 1980s reflect chronic misallocation of resources under central planning and reveal how little growth has been generated by substantial investment.

Under the circumstances, the first challenge is to use resources more efficiently by removing price controls and other policies that distort resource allocation. Then, external assistance can help establish a functioning market-based system by providing technical help designing and implementing the legal systems, regulatory framework and other measures needed to foster private sector development. For if domestic resources continue to be wasted, additional external resources will not be forthcoming.

Table 2. Domestic Resource Mobilization

	Savings Rate in 1986 (% of GDP)[a]	Investment Rate in 1986 (% of GDP)	ICORs[b]	
			1970s	1980s
Bulgaria	n.a.	n.a.	4.2	7.3
Czechoslovakia	n.a.	n.a.	5.0	10.0
Hungary	25.0	26.0	6.5	18.0
Poland	30.0	29.0	6.9	n.a.
Romania	n.a.	n.a.	4.1	7.4
Yugoslavia	40.0	38.0	6.9	55.7
Averages	31.7	31.0	5.6	19.7
Memo Items				
Industrial Countries	20.7	19.9	5.5	7.5
Developing Countries	24.0	23.0	4.7	7.2

a. GDP is gross domestic product.
b. ICOR is Incremental Capital-Output Ratio.
Note: Under these circumstances, the first challenge for external assistance must be to help increase the efficiency with which resources are mobilized and employed; obviously, this must be one of the central objectives of the transformation process. These aggregate measures suggest there is much room for improvement.
Source: The World Development Report, 1990, and The Institute of International Finance, Inc., *Building Free Market Economies in Central and Eastern Europe: Challenges and Realities,* April 1990.

The External Sector

External conditions have not been favorable since the reform process began. Soviet economic decline has adversely affected all six countries of the region, limiting the supply of imports and, increasingly, the demand for exports. (This major development is discussed more fully in the next chapter, in the context of the two economic scenarios developed there.) Trade with the industrial countries has grown, but from a small base, and the recent slowdown in the West has hurt trade prospects there, as well.

Two issues on the external side deserve special consideration: external debt and the recent change in the terms of trade within the Council of Mutual Economic Assistance (CMEA).

External Debt

Since the 1970s, Poland, Hungary, Yugoslavia and Bulgaria — four of the six countries in the region — have built up sizable external debts in convertible currency. At the end of 1990, of the six countries' total debt of $108 billion, Poland accounted for 45 percent; Hungary and Yugoslavia, just under 20 percent each; and Bulgaria, about 10 percent (Table 3).

Poland's external debt, which stood at $48 billion in early 1991, constituted the largest external financing problem in the region before the recent debt reduction. Atypically, four-fifths is owed to official creditors, almost all bilateral. Most of the balance is owed to industrial country commercial banks.

Between 1981 — when Poland first experienced debt-servicing difficulties — and 1990, these two main groups of creditors entered into 13 rescheduling agreements with the government. The official creditors met many times in the Paris Club and rescheduled most of the principal and interest (including moratorium interest on rescheduled debt) due them. The commercial banks, meeting separately, usually rescheduled about 95 percent of principal. The $20 billion increase in Poland's external debt since 1981 is largely due to the accrual and "capitalization" of interest payments due the Paris Club creditors.

For 1991, Poland's external debt-service obligations (both principal and interest) are about $8.3 billion. In the absence of any program of debt reduction, annual amortization obligations would range between $3.5 and $4.4 billion through 1995. Total annual debt-service obligations would rise, reaching $9.2 billion in 1995, even if Poland reduced its outstanding stock of debt by meeting the scheduled amortization payments. These would constitute an extraordinary burden on the Polish economy.

Thus, the announcement in March 1991 that the Paris Club had agreed in principle to a debt-reduction program is in most respects

Table 3. Convertible Currency External Debt in 1990
(US$ billions)

	Bulgaria	CSFR	Hungary	Poland	Romania	Yugoslavia	Total
Total Debt	10.6	7.9	20.2	47.9	0.5	20.6	107.7
Type of Debt							
Long-Term	7.1	5.0	17.8	44.8	0.3	17.7	92.8
Short-Term [a]	3.1	2.9	2.4	2.1	0.2	2.9	13.6
Interest Arrears	0.4	0.0	0.0	0.9	0.0	0.0	1.3
Type of Creditor							
Official	2.7	3.1	4.4	38.0	0.3	11.3	59.7
Multilateral	0.7	0.4	2.4	3.9	0.0	4.2	11.6
Bilateral	2.0	2.7	2.0	34.1	0.3	7.1	48.2
Private	7.9	4.8	15.8	9.9	0.2	9.3	47.9
Memo Items							
Debt as % of GNP	22	6	32	30	1	16	—
Debt as % of Exports [b]	505	109	223	387	13	108	—
Debt Service (US$ billions)	2.6	1.5	3.7	7.2	0.1	4.3	—
Debt-Service Ratio [c]	124%	21%	41%	58%	3%	23%	—

a. Excludes some very-short-term trade financing.
b. Exports of goods and services for convertible currency .
c. Debt service as a percent of export earnings.
Source: Various official sources.

heartening. It is discussed more fully below under the heading of debt reduction in Chapter 3.

Bulgaria is the other country of the region unable to service its debt at the present time. Although the absolute amounts are not large, debt in 1990 had topped 500 percent of convertible currency export earnings. Bulgaria accumulated interest arrears in 1990.

Hungary has been at pains to avoid debt reschedulings. In the 1970s and 1980s, the Hungarian government borrowed heavily and, unlike the other countries in the region, was able to tap the international bond markets in addition to borrowing from commercial banks and official sources. Although debt is high in relation to GNP (32 percent), debt service as a percent of convertible currency export earnings (41 percent in 1990) has been manageable.

Although *Yugoslavia's* external debt position has been quite comfortable in recent years, inasmuch as the country ran a current account surplus from 1984 through 1989 and accumulated reserves, there was a $3 billion convertible currency current account deficit in 1990. The prospects for current account surpluses in the future depend very much on progress in domestic stabilization, which is, in turn, contingent on political developments.

CMEA Changes

In contrast to the debt situation, the change in the terms of trade with the Soviet Union is a recent phenomenon, having taken effect in 1991. Moreover, it affects all six countries of the region.

Last year, the member nations of the CMEA agreed to stop trading at prices set in transferable roubles (and settling bilaterally in transferable roubles) and instead to trade at world market prices and settle in convertible currencies, beginning in January 1991. Several bilateral barter agreements continue in force. For example, the Soviet Union was reported to have recently agreed to trade 6.5 million tons of gasoline with Bulgaria — about a third of Bulgaria's annual need — for forklifts and other manufactured goods. Nonetheless, there is progress toward setting up more conventional international trading arrangements within the region and between the six countries and the Soviet Union.

Although trade among the six countries of the region will be affected, it is not the central issue, insofar as the external financial requirements of the individual countries are concerned. Intra-six trade is relatively well balanced bilaterally — in broad terms, Hungarian exports to the CSFR are similar in type and volume to its imports — and, generally speaking, the volume of trade among the Six is small compared with the bilateral trade each of them has had with the Soviet Union (Annex 1, Table A1).

Table 4. Change in the Terms of Trade for Eastern Europe

	With the Soviet Union	*Overall*	*As a percentage of GNP*
Bulgaria	-38.90%	-33.50%	-6.20
CSFR	-48.80%	-21.90%	-2.60
Hungary	-41.00%	-17.30%	-3.30
Poland	-37.20%	-22.30%	-2.00
Romania	-46.20%	-3.20%	-1.10
Yugoslavia	-51.30%	-7.50%	-1.10

Note: Change is estimated from 1989 data.
Source: Based on Study Group Secretariat analysis and national statistical sources.

The principal effect of the change in the terms of trade will be to lower the overall value of Soviet trade as a share of total trade; to raise the cost of oil and other types of energy imports to the Six; and to lower the unit value of their exports, which must now face direct competition from the industrial countries for Soviet markets.

The analysis for this report, based on data for 1989 (the most recent year for which a product decomposition of bilateral trade is available), suggests that Bulgaria will suffer the most severe effects (Table 4). Its terms of trade with the Soviet Union are expected to deteriorate by 39 percent; that is, the combined effect of falling prices for Bulgaria's exports and rising prices for its imports from the Soviet Union have an effect equivalent to a 39 percent rise in the cost of its Soviet imports. That deterioration translates into a 34 percent deterioration in overall trade terms, because so much of Bulgaria's trade is with the Soviet Union. That, in turn, is equivalent to about a 6 percent decline in gross national income (GNI).

Hungary, Poland and the CSFR will also suffer significant setbacks. Romania, which exports five and a half times as much (and imports one and a half times as much) in trade with the West as it does with the Soviet Union, will suffer a major reversal in terms of trade with the Soviet Union, but a relatively small setback to its overall trade terms and to its

GNI. The same is generally true of Yugoslavia.

Although the orders of magnitude suggested by this analysis are reliable enough, the figures in Table 4 are rough estimates. Using 1989 data and applying conversion factors to broad categories of trade takes no account of the precise composition of trade, how that composition may have changed in the past two years, or how it will change in the future. The analysis is especially sensitive to the oil price; the 1989 internal CMEA price was equivalent to about $7.00 per barrel, valuing the transferable rouble at a realistic exchange rate of about $0.47, and the assumption used here is that the average price in 1991 will be about $20.00. The official transferable exchange rate of $1.59 to the rouble would clearly be far too high to use, but the estimate used here — which is based on the average cross rates (for example, the rate of the zloty to the transferable rouble combined with the zloty to the US dollar) — is still a matter of some judgment. So, too, is assumption on the price of oil, which is discussed more fully in Chapter 3.

When these changes in the CMEA were adopted, there were indications that the Soviet Union might be willing to soften the impact of the shift in the terms of its trade with Eastern Europe. For example, all of the CMEA countries have had transferable rouble trade surpluses with the Soviet Union in recent years. These accumulated trade surpluses could be applied to Eastern Europe's future deficits. In the fall of 1990, it was reported that "Hungary and the Soviet Union have agreed to convert Hungarian claims on the USSR stemming from last year's bilateral surplus at an implied rouble/dollar rate of 1.09, giving Hungary a balance of $0.7 billion to be used in settling deficits vis-à-vis the Soviet Union in the future." A similar agreement was also reached regarding CSFR claims of 3.8 billion transferable roubles. The value of their claims are somewhere between $2.7 billion and $6.3 billion. Nonetheless, and especially in view of the uncertainties regarding the Soviet Union, the change in the terms of trade is likely to have a major adverse impact on Eastern Europe's short-term prospects for growth.

Structural Change

Against these difficult external circumstances, how much domestic structural reform has been achieved to date? What is the agenda for future structural reform?

Structural reform does not mean simply expanding the role of the private sector and diminishing that of the state, although privatization plays a large part. Because the success of the transformation depends on how well the state sets the stage for private economic activity, improving public administration in the region is a high priority. The role the state will play in the economy should be far more indirect, but no less crucial, and in some ways, economic governance will become more subtle.

For a market-based economy to operate efficiently, basic information — about prices, in the first instance — should be available as a basis for making decisions. Then, to be useful, those decisions must lead to agreements between individuals to cooperate, agreements that must be secured as reliably as possible. There must be incentives to inject effort into the system and to lead individuals to use resources as efficiently as they can, which means that it must be possible to reward valuable workers and let unproductive ones go. Private property must be clearly defined, and property rights must be protected by the state. Productive enterprises must be rewarded by profits and unproductive enterprises must not be allowed to absorb more resources; bankruptcies must be permitted. And goods that are intrinsically public must continue to be provided, or paid for, by the state. Table 5, which gives an overview of progress in five important areas of structural reform, shows that significant strides have been made. Most prices are free of administrative control in most of the countries of the region. Plans to privatize state-owned enterprises are well advanced, although few of the large enterprises that dominate these economies have actually been privatized. Most state trading monopolies have been disbanded, but restrictions on both imports and exports continue to be applied. Moreover, enough administrative discretion remains that international trading is still a more uncertain business than it need be. And, with the possible exception of Romania, every country in the region has recently adopted an

Table 5. Structural Reform in Eastern Europe

	Bulgaria	*CSFR*	*Hungary*
Price Reform	All prices except energy freed 2/91.	Prices freed in sectors believed to be competitive.	Domestic pricing freed since 1988. More than 92% now freed.
Privatization	Planning to privatize state firms. No timetable set.	Started privatizing small businesses. Foreigners can bid only if citizens don't buy.	National Property Agency set up. 130 of 3,000 salable firms privatized in 1990.
Foreign Trade	As of 1/89, all firms free to conduct foreign trade. Decree of 2/90 liberalized import of all goods. 300% duty imposed on all exports except art.	As of 2/91, exporters of goods in short supply must have have licenses, as must importers of petroleum products and munitions.	90% of imports free from control.
Convertibility	Import and export of Leva prohibited (non-convertible).	Liberalized in 1991, but local currency not necessarily convertible.	Net export earnings held until year-end in Forint accounts with National Bank.
Exchange Rate Policy	Since 2/3/91, Leva has floated. Rates agreed daily by commercial banks and clients and posted by National Bank on following day. One rate for all types of transactions.	Crown fixed against US$, subject to periodic adjustment. In 12/90 devalued 17% to 28 crowns/US$. One rate for all types of transactions.	Forint is fixed against a basket of currencies, subject to periodic adjustments.

Source: Various official sources.

Poland	*Romania*	*Yugoslavia*
Most price restrictions ended 1/90. 10% of prices now controlled.	Most prices still controlled.	75% of prices freed by 12/89.
8,000 firms to be privatized. Eight sold so far. Foreign share limited to 10% without permission.	Privatization bill sent to Parliament. Plans to privatize 50% of capital stock of economy over 3 years.	Ownership issue difficult because of decentralized nature of worker self-management system.
No restrictions on imports. Export restrictions on 15 items accounting for 1% of total exports.	All citizens and foreigners can now conduct hard-currency trade.	All public and private firms can conduct foreign trade. 87% of imports free from restriction as of 2/90. Tariffs low, uniform; QRs on some imports.
Resident convertibility for current transactions. Profit repatriation limited use of net hard-currency earnings controlled.	Started phased transition to convertibility.	Convertibility for commercial transactions since 12/89. Government suspended convertibility into US$ for repatriation end of 1990.
In 1/90, Zloty devalued from 6,000/US$ to to 9,500/US$, bringing official rate in line with with street rate, legalized at same time. Exchange rate set against US$ for all kinds of transactions.	In 2/91, dual exchange rate system introduced. 11/90 Leu devalued to 35/US$. Devalued on 4/1/91 to 60 Leu/US$.	Dinar pegged to Deutsche Mark subject to periodic adjustments. Rate of 7/DM set 1/90, revised to 9/DM in 1991 for all transactions.

exchange rate regime that *can* (temporary misalignments notwithstanding) provide a single, reasonably stable and realistic rate of exchange.

The Quality of Economic Information

Decontrolling prices and implementing a realistic exchange rate policy are part of improving the base of information available to private individuals and enterprises, as well as changing the terms on which they do business.

In addition, there is a critical need in the region to improve the quality of financial information. Accounting rules, standards and practices that more fairly reflect the value of the assets and liabilities of enterprises, and their value as on-going concerns, must be introduced. Consistent methods of depreciation accounting, for example, are needed in most of the region.

This need has already been recognized in both the public and private sectors in most of the Six. In fact, most of the largest international accounting firms have set up offices in the capitals of the region. A great deal of their work is to help with the evaluation of state-owned enterprises, a judgmental exercise in many instances. In addition, and perhaps more important, they are part of a broader flow of technical knowledge that is needed to facilitate the economic transformation of the region.

The Financial Sector

One of the key conduits of economic information, the financial sector is also the vehicle for mobilizing private savings and allocating them to investments. In view of how inefficiently these activities have been performed in the past, it is not surprising that all the governments of Eastern Europe have given a high priority to reforming the financial sector and, in particular, the banking industry. This attention is sorely needed.

All six have moved away from the type of banking system organized as a single centralized state bank channeling resources to public sector enterprises on the basis of plan requirements. All have now moved to create two-tiered banking systems, making a central bank out of the core of the old state bank and commercial banks out of its old deposit-taking and lending departments (Table 6, lines 1 and 2). Each country has a long way to go, however, before the new banking system will be developed enough to meet the needs of a market economy.

To mobilize domestic savings, the banks must attract deposits from savers, both individuals and businesses, with positive real interest rates and efficient and convenient services. For, although the savings rates in these countries are high, a large proportion of the money supply is held in cash. To act as effective intermediaries, the banks must also develop their credit and lending capabilities. Under previous regimes, the analysis of credit was not an important factor in making loans to state enterprises, but it is crucial in lending to private sector borrowers.

By the same measure, to serve as a trustworthy depository and custodian of the savings of the public, the banking system must ensure that its own creditworthiness is unquestioned: It must earn the confidence of the community. Banks' loan portfolios must be strengthened to minimize the risk of future failures.

And finally, in order to function as their nations' payments mechanisms — a crucial role — they must develop and maintain systems that will facilitate efficient, prompt, low-risk, low-cost financial transactions. Such systems do not generally exist today in the region. Checking accounts are difficult to open and to use; check clearing is slow and costly; facilities for wire transfers of funds are limited. In general, banking systems would be much more effective if they were made user-friendly. There is much room for improvement, and further enhancements could be made quite rapidly.

In *Poland* the National Bank is now largely autonomous and responsible for supervising and regulating the banking system, as well as monetary policy. The bank no longer has to submit an annual credit plan to the parliament. Public sector credit at the central bank is limited to 2 percent of the budget and must be repaid within the fiscal year. The nine commercial banks spawned by the old National Bank join several established, state-owned specialized financial institutions and some new

Table 6. Financial Sector Reform in Eastern Europe

	Bulgaria	*CSFR*	*Hungary*
Reorganization of the Central Bank	National Bank divested all commercial banking activities in 1990 but retains significant share interest.	Introduction of two-tier banking system in 1990, leaving state bank with monetary and supervisory functions only.	Two-tier banking system introduced in 1987, when central bank's credit function transferrred to separate commercial bank.
Creation of Financial Institutions	Some 59 commercial banks created from lending departments of former central bank in 1990.	Several commercial banks operate independently.	About 40 commercial banks operate domestically; some 260 savings cooperatives play significant intermediation role.
Credit Allocation and Monetary Policy Tools	Credit ceilings in force.	Credit-ceiling policy in force.	Credit abolished; monetary policy relies increasingly on indirect tools — interest rates, reserve requirements, and rediscount rate.
Interest Rates	Bank lending rates must be set within 2% of refinancing rate established by National Bank.	Some rates freed.	Substantial liberalization of interest rates, including those on household deposits.
Foreign Banks	None.	Foreign banks allowed to open branches independently; joint ventures also allowed. First joint ventures and independent branch set up in 1991.	Foreign equity participation in nine banks.
Domestic Equity Markets	Law drafted "to set up a stock exchange," but no timetable set.	Domestic exchange opening in 1991.	Stockmarket established in Budapest in 1989, operational in 1990.

Source: Institute of International Finance, *Financial Sector Reform in Central and Eastern Europe*, June 18, 1991 and various sources.

Poland	*Romania*	*Yugoslavia*
Introduction of two-tier banking system completed in 1989.	In 1990, National Bank of Romania gave up commercial banking activities.	Two-tier banking system introduced in 1971. In 1989, banking reform law strengthened the National Bank.
Sixty banking licenses granted.	Creation of large state-owned commercial bank to take over commercial banking activities.	About 80 new commercial banking licenses granted after financial audits and under relicensing procedures. 1989 reforms restructured commercial banks to more profit-oriented.
No formal credit ceilings; main monetary instrument for banks is refinement rate; NPB bills regulate bank liquidity.	Central credit allocation remains.	Subsidized credits now on-budget, but National Bank must still finance public borrowing requirement without statutory limit.
Substantial liberalization of interest rates.	Interest rates held to a range over the lenders' deposit rate.	Interest ceilings exist.
Foreign banks may operate; joint ventures allowed.	Foreign banks may conduct both foreign and local currrency business.	Limited opening for joint ventures.
Stockmarket may open in 1991.	No plans for a stockmarket.	Regional stockmarkets set up in 1990.

private sector banks. By mid-1990, the National Bank had granted 60 banking licenses, including one to an American and one to a Dutch bank. But the assets of the private banking system remain small compared with those of the state-owned banks.

In *Hungary*, the three largest commercial banks were created from parts of the National Bank. They face strong competition from established cooperative banks and newer, smaller banks, some of which have foreign participation. The smaller banks have taken market share by offering positive real interest rates and competing in other ways for deposits. The activities of the National Bank are now largely confined to issuing currency and regulating depository institutions.

However, restrictions remain on what a commercial bank may charge for certain classes of loans and offer on certain classes of deposits. Mortgage rates are still capped below the real cost of money. And it is still difficult to get a checking account. It has been estimated that there were no more than 100,000 checking accounts in the entire country at the end of 1990. Last year, banks were turning away customers, because the internal accounting systems were unable to cope with additional work. Checks took as long as a month to clear, a high degree of inefficiency in the payments mechanism.

In principle, the autonomy of the *Yugoslav* National Bank has been increased recently, but it is still required to extend loans at preferential rates to the agricultural sector. The commercial banking system should shortly become subject to new reserve requirements, and banks will have to issue shares, which in theory should make them more profit-oriented. But those shares will not be widely available for ownership. The close relationships that have existed in the past between banks and those to whom they lend are likely to continue.

In the *CSFR*, financial sector reform did not begin until 1990 and is, therefore, further behind than in Hungary or Poland. Two new banks — one for each republic — were created from the commercial banking departments of the old central bank. The banks remain state-owned, at least for the moment. Theoretically, they could compete, but they are currently concentrating on business in their own republics.

The large number of commercial banks in *Bulgaria* might suggest that the system there is more competitive and developed than is, in fact, the case. Little change has occurred in management or in the approach to credit allocation. The central bank continues to set credit ceilings, and commercial banks have their lending rates determined within a narrow 2 percent band by central fiat.

And in *Romania*, too, financial system reform is at an early stage. The banking system will start in upon reform from a somewhat stronger position than many others in the region, because bank balance sheets were cleared of non-performing assets when the government ran budget surpluses in the last several years. The government is drafting financial reforms and intends to move quickly to flexible interest rates. Starting in April 1991, deposit and borrowing rates have been freely negotiated between banks and their customers.

Even in the countries that have made the most progress, much remains to be done. Most of the newly created commercial banks (Romania's excepted) are burdened with large problem assets — claims on insolvent state-owned industries — from which the nascent banking system must in some way be unburdened: The Yugoslav proposal of a national agency that takes over the impaired assets of commercial banks and sell them is a promising one. Reserve requirements and other basic regulatory standards are only now being established and put in place. The interbank market is poorly developed — if it exists at all — in most of the six countries of the region, and basic financial procedures need to be introduced (Box 1).

Much attention has focused on the creation or re-creation of formal stock exchanges, and several have been set up in East European capitals in recent months. This is a welcome development, but to function effectively, these exchanges require financial instruments — shares issued, listed and traded — and investors, traders and dealers (institutions or individuals) who are ready, willing and able, in terms of both resources and skills, to buy and sell those securities. It will take time for them to become established as an important allocative mechanism for capital.

Markets for other financial instruments should be encouraged and developed. Markets for debt instruments, ranging from interbank funds

Box 1: Appropriate Financial Systems

Despite the urgency of upgrading financial systems, the Six must be very discriminating about the technologies and structures they adopt from the industrial countries. Computerization, for example, might have a far lower priority than it would seem at first glance. In finance, as in management, systems that do not work well on paper cannot generally be computerized. The wholesale adoption of integrated computer systems in new functions just being developed can overwhelm even the most able personnel. Take the area of loan and credit appraisal: it is far more important for commercial bank loan officers to understand basic finance and their supervisors to understand risk diversification than for an integrated system of credit approval and review to be computerized. Personal computers may help, but centralized (and decentralized) systems are usually best built from the ground up.

And as securities markets develop, there is no reason to require the physical transfer of ownership papers to complete transactions. That some industrial country markets use such systems today is a historical accident that does not need to be repeated. A book entry system of ownership is much more efficient. But that does not necessarily imply a need for sophisticated computer systems. It is more important that the system be truly transparent, properly supervised and reliably run. To that end, it may be best, particularly in the early stages of development, if the entries really are made in a book!

Finally, some market structures should, if at all possible, be eschewed from the outset: specialized housing finance institutions and secondary mortgage markets, for instance. If desired, home ownership can be encouraged by tax preferences, regardless of the financial intermediary structure. There is no reason, by regulation or law, to forbid ordinary commercial banks from home lending or to prevent traditional home lenders from diversifying their risks across types of loan. Nor is there any urgent reason to encourage a secondary mortgage market. The specific liquidity and spread reasons for their development in industrial countries — the United States, in particular — do not arise if arbitrary intermediation specialization is avoided in the first place.

Source: Discussions with Study Group members and staff.

to commercial paper to long-term bonds, are especially useful. Other financial markets, such as those for futures or options, should be developed over time.

The purpose of all of these markets is to permit companies to raise new capital, to provide savers with opportunities to invest, to provide for liquidity through an effective secondary market, to enable buyers and sellers to put values on their securities and, at a more advanced stage, to provide the central bank with the monetary policy tool of open market operations.

Apart from domestic considerations, the further development of domestic capital markets, together with a more effective banking system, should prove attractive to foreign financial flows. Foreign investors and lenders have a higher comfort level if they can operate within a financial sector that provides them with some measure of liquidity, market pricing, valuation, short-term investment facilities, and efficiency and safety in their financial transactions in general.

In the near term, of course, it is the banking system that must play the pivotal role in the financial sector, and its reform is the first priority.

Fortunately, what needs to be done is broadly understood, and there is political support for reform in much of the region. The six core countries of Eastern Europe have made use of a good deal of technical assistance from the International Monetary Fund (IMF), the World Bank and its subsidiary, the International Finance Corporation (IFC) and national authorities, such as the US Treasury Department and the Federal Reserve Bank of New York.

Other aspects of financial sector reform — the development of capital markets and the evolution of other kinds of institutional investors and financial intermediaries — are generally at a nascent stage. The legal and institutional frameworks for these market mechanisms need to be developed. They are important for encouraging domestic savings, establishing an effective payments mechanism and generally facilitating the functioning of a market economy. Furthermore, the evolving process of privatization will create new assets, which must be owned, traded and intermediated in the private sector, and a financial market infrastructure must develop for this to happen effectively.

Privatization

All the governments in the region have expressed their intention to privatize existing state-owned enterprises. The task, whose scale is unprecedented, is both difficult and contentious. It can be argued that several preliminary steps are needed.

- First and foremost, suitable legal and administrative frameworks must be set up to define ownership and other rights, and all the normal legal obligations of commercial practice; to charge a group of civil servants and politicians with overseeing the process; and to provide for the disposition of public assets.
- Macro-economic stabilization and the liberalization of prices and trade are needed to give potential investors the benefit of clear price signals on which to base their bids.
- Expert valuations, based on informed estimates about national and international market conditions and expectations of future earnings, are needed as a useful check against market failure in the sale of an enterprise.
- Enterprises that are encumbered with debt or unneeded labor may have to be restructured financially and operationally before they can be sold.

Progress on the first step — establishing the legislative and administrative framework — is well advanced in the CSFR, Poland, Hungary and Yugoslavia. Progress on the other issues is patchy. Nonetheless, a few privatizations have been successfully completed.

In *Hungary*, the privatization of large state enterprises began in 1989 under a new law that permitted so-called "spontaneous" privatizations — the sale of enterprises by their managements, with little direction or outside supervision. Some large sales went quickly and well. But others were controversial. For example, the state-owned electric fixtures firm, Tungsram, had been sold to a small group of foreign investors who sold it back to the government at a considerable profit before General Electric bought a controlling interest in it in 1990. Later, when the value of the state tourist agency, Ibusz, rose soon after it was sold, there was an outcry from critics who thought it had originally been underpriced.

In 1990, these defects were addressed in a new law that set up a State Property Agency to oversee privatizations. Now a program has been drawn up to privatize 40 percent of the state assets in the next three years and 80 percent over the next 10 years. Generally, the aim is to sell a major stake in most large enterprises to a small enough group of investors for the new owners to be in a position to oversee management. Local councils, insurance funds, and the workers of the privatized firms themselves will be able to buy small shares of the enterprise at below-market prices. The Hungarian government will grant shares to the municipality in whose territory the enterprise's facilities are located, in exchange for title to the land. Otherwise, as a general rule, the intention is to maximize public sector revenue from a sale, either through competitive arm's-length bidding or by bringing the enterprise to market.

The State Property Agency plans to directly dispose of about 600 of the larger companies. In addition, it will oversee the sale of some 400 smaller companies that may organize their own privatizations. The agency will also supervise local authority sales of small retail trade and service companies.

Poland's privatization program is underway, as well. A privatization law enacted in July 1990 created a flexible process for privatization and gave a new Minister of Ownership Transformation a role not unlike that of the Hungarian State Property Agency. As in Hungary, smaller enterprises will be sold by local governments, while larger viable state-owned companies will be transformed into stock companies and their shares sold under the Ministry's supervision. Enterprises that are not viable will be liquidated, and their assets will be sold, leased or scrapped.

The overall objective of the program is different, however, with greater emphasis being given to widespread ownership of the larger enterprises and less to raising public sector revenue. Ownership vouchers will be issued to enterprise workers, to the Social Security Fund and other financial intermediaries, such as insurance companies and pension funds. Some 20 percent will normally be kept in government hands to be sold later, and about 30 percent will be given or sold to Polish citizens at large. But private citizens' vouchers will be exchangeable only for shares of new private investment funds that will use the vouchers to buy directly into the privatized entities. The shareholdings of these financial intermediaries should be large enough to exert an effective outside influence on company policy.

In August 1990, the Polish government put up seven companies for privatization along these lines. There were some initial teething troubles, and two of the companies were excluded from the final public offering, but a program for 1991 has been approved. The goal is to privatize half of the state's productive assets over the next three years.

In February 1991, the parliament passed implementing legislation that envisions different procedures for different categories of enterprises. A distinction will be made between the 500 largest firms (by sales value) and smaller ones. The object is to seek a diversified ownership structure for the large firms, while permitting others to be sold to individual buyers.

The *CSFR's* program is the newest, unveiled in early 1991. It is similar in most respects to the Polish program in that it divides responsibilities between the central and local government and makes use of vouchers — distributing some and selling others — with the objective of achieving widespread share ownership. But the government has also made a special point of attracting foreign purchasers. And, at the risk of complicating the program in the short term, it plans to allow previous private owners to regain control. The restitution offer is open only to owners whose property was nationalized after 1955 and applies mainly to small and medium-size service firms and to land.

The overall goal of the CSFR's program is to privatize 70 percent of state assets in a period of three years, concentrating first on small-scale enterprises under programs run by special local committees and, in a second phase, on larger enterprises.

There is something to be said for the intended variety of approaches both within and among countries in the region, in that there should soon be a wide body of practical experience from which to learn. But two dangers lie ahead.

- Some aspects of the schemes may be overly elaborate, although the voucher programs in the CSFR and Poland should avoid this criticism.

- Many state enterprises will turn out to be worth very little, regardless of the costs sunk into them or the results of formal valuation exercises. Witness the experience of the Treuhandanstalt in East Germany.

Much depends on the quality of implementation, on whether transactions are genuinely competitive and at arm's length. Even if such transactions yield low revenues for the public purse, it is important that they be understood as fair sales if they meet these criteria. Early successes — defined as effective transfers of ownership and control to the private sector, at fair value, and with a reasonable chance of profitable future operation — are clearly desirable.

Because the process of privatization will take several years to complete, state enterprises will continue to account for a major share of output for some years to come. Governments in the region will only gradually withdraw from direct control of parts of their national economies. But it is important that, in the meantime, they should end special public sector access to credit and other resources as quickly as possible.

Deregulation

In the context of the transition from central planning to market-based economic systems, the most important aspects of deregulation are the freeing of prices and interest rates.

Some governments in the region have taken significant steps in this direction. With the 1990 introduction of reforms in *Poland*, for example, the proportion of domestic prices set by the state fell from 50 percent of the gross domestic product (GDP) to about 10 percent, and now the rules apply only to public transportation, energy and rent. Foreign prices were also set free, when the state ceased allocating foreign exchange and the zloty was devalued by 50 percent (relative to the official rate in December 1989), thereby bringing it to the level prevailing in the street.

In *Hungary*, the proportion of consumer goods whose prices have been freed (subject to the general rule that they cannot exceed the price of imports) increased from 62.5 percent in 1989 to 77 percent in 1990. For producer goods, the freed proportion increased from 66 percent in 1989 to 75 percent in 1990. And *Yugoslavia* has also moved to free prices in recent years. By December of 1989, 75 percent of the prices in the Industrial Producer Price Index and 70 percent of retail prices were freed.

The importance of deregulation is that, without it, markets cannot function properly and the scope for individual enterprise is stunted (Box 2). Not only should prices and interest rates be free to change in response to changing supply and demand conditions, but suppliers and customers in all types of markets should be free to shop around. This freedom can be voluntarily foregone under long-term contracts between individuals and private enterprises, but should not be government constrained.

A caveat is necessary on the issue of deregulating public utilities, such as the telephone, electricity, gas and sewerage networks. Clearly, if natural monopolies are converted from public to private ownership and operation — with all the advantages that that confers, in terms of encouraging efficiency and innovation in operations — some form of regulation over prices and levels of service will still generally be needed. Otherwise, the private monopoly may set price levels above, or service levels below, those that would be optimal from the broader viewpoint of the economy at large.

Integration with the International Economy

Many foreign investors that suspect they may have opportunities in Eastern Europe are still unsure of the specific conditions they face. There are several basic strategic issues on which judgments have to be made before they commit to trade, invest or otherwise do business in the region. The governments of Eastern Europe must look at their external economic policies from the perspective of these foreign businessmen to realize as much from integration with the international economy as the countries might wish. (Annex 2 reviews the rules and regulations facing foreign firms and describes some recent experiences with joint ventures.) Some of the critical issues are:

- What sorts of clearance are needed to start an operation, and how

Box 2: Releasing Private Sector Energies

The private sector in Eastern Europe can be very efficient; entrepreneurs abound. An example is the case of a Hungarian state-run crop spraying company that had about 260 staff members supporting fewer than 20 pilots and a handful of planes. Several of the pilots left about 18 months ago and set up their own firm. The new company had difficulty raising capital but, once backing was found, quickly became profitable and competitive, while the state firm now faces bankruptcy.

In such stark instances, the state enterprise should perhaps be allowed to fail. It is hard to imagine how it could be privatized, with bleak commercial prospects, or restructured into a viable enterprise in the public sector. The organization itself would seem to have no social or economic value.

As a general matter, equity ownership can be stimulated not only through privatization but, equally important, by encouraging new firms to develop.

Source: Discussion with Study Group members and staff.

long do they take?

- What preconditions may be imposed on operations — export targets, employment, use of particular facilities or materials? And are there special incentives to invest — tax holidays, secure access to inputs and the like? Are ownership rights clearly established, and how far do they extend? What obligations — such as for environmental cleanup — may carry over from previous owners?
- How available and reliable is the infrastructure needed to support operations? How effective and equitable is the tax regime? Are commercial disputes properly and fairly settled? How reliable are services? What is the quality and availability of labor?
- How certain are the rules governing the availability of foreign exchange and repatriation of fees, royalties and profits?

Poland, Hungary, the CSFR and Yugoslavia have all taken steps to encourage direct foreign investment and trade. There are now very few limits on the types of legal structures that can be used or the extent of foreign ownership in a joint venture. *Poland* has gone so far as to give foreign enterprises and joint ventures better tax terms than their Polish counterparts' since December 1989. In *Hungary*, foreigners can open and maintain hard currency accounts in commercial banks, and any joint venture may buy real estate, something that is not generally the case elsewhere in the region.

Some sectors, including public utilities and industries involved in national security, are not freely open to foreign investment. There are limits or delays on the repatriation of profits earned in domestic currencies. And, as a general rule, there is an unusually high degree of administrative judgment involved in the approval and licensing of foreign investments. Thus, restrictive rules and uncertainties about the way regulations will be applied still inhibit foreign investors.

Stabilization

The transition to market-directed economies necessitates fundamental changes in the ways in which governments pursue macroeconomic objectives. As they limit their micro-economic interventions, they can no longer achieve economic goals by fiat and must, instead, use indirect monetary and fiscal measures. To ensure their effectiveness, they must simultaneously develop the necessary institutions and procedures.

Price Stabilization and Sustained Growth

Monetary Policy. To execute monetary policy, a country must have an independent banking system that actively seeks deposits and provides financing, so that a significant part of the credit extended and transactions conducted in the economy pass through the banking system. Where fractional reserve banking exists, the central bank can then influence economic activity by increasing or decreasing bank reserves, thereby affecting the amount of money and credit available to finance investment and consumption.

Effective use of monetary policy also requires that the monetary authorities avoid automatically monetizing budgetary deficits, a common practice of the previous East European regimes. The Polish government has enacted legislation limiting governmental borrowing from Poland's central bank to 2 percent of budgeted expenditures. The Yugoslav government abolished all legal provisions entitling the federal government to automatic access to credit from the National Bank of Yugoslavia.

Most of the countries of the region have taken the first step toward developing the institutional framework for using conventional monetary measures to influence economic activity, as described in the section on financial sector reform, and monetary stabilization has been pursued with varying degrees of success to date (Table 1).

Fiscal Policy. Historically, under the central planning system, the governments of the region typically formulated annual and five year plans for their economies. To implement the plans, the planning agency would issue detailed instructions to all sectors of the economy, using mandatory quantitative targets, state procurement and set prices to control activity, and setting wages according to the amount available in the central wage fund.

One country that did not follow this pattern was Yugoslavia. Microeconomic decision-making there was largely the prerogative of enterprises owned and managed by their workers. The system of worker self-management was flawed, however, and bankruptcies rarely occurred because the financial system ultimately absorbed the costs of enterprises' uneconomic decisions regarding wages and investment.

Hungary abolished rigid central planning in 1968, and subsequently the other governments in the region (excluding Yugoslavia) began to deviate from the pattern of central control. These governments, however, found other means to maintain their influence over the allocation of resources in their economies. The use of subsidies in state budgets, for example, distorted firms' decisions and protected inefficient firms from market forces.

Hungary and Poland have been in the forefront of liberalization, but they still have far to go. Although Hungarian budgetary subsidies have declined since 1986, they still accounted for a high percent of the country's GDP in 1990. In Poland, they accounted for more than 15 percent in recent years.

Effective fiscal policy requires the management of both revenue and expenditures that, among other things, can be employed to promote or retard overall levels of economic activity. To be able to use fiscal policy for this purpose, the East European countries will have to develop and implement new tax systems and budgetary procedures.

To replace the revenues that largely derived from enterprises under the previous regimes, the countries need new tax structures compatible with their emerging market economies. The first East Europeans to start down this path were the Hungarians, whose comprehensive tax reform began with the introduction of a personal income tax and a value-added tax in January 1988 and a corporate income tax in 1989. These measures increased the transparency and neutrality of the tax system and reduced the scope for negotiation of tax liabilities. The Poles plan to make sweeping changes in their tax system in 1991 and 1992, with the introduction of personal and corporate income taxes, as well as a value-added tax.

Ameliorating the Costs

The implementation of effective reform programs will entail heavy costs in terms of living standards. One index of these costs will be the unemployment rate, for there is little doubt that, if the reform measures are effective, and if productivity is to be improved, a large percentage of the labor force will become unemployed. Indeed, a high unemployment rate during the transformation period will reflect the extent of the reform programs rather than indicate any failure. Clearly, however, if high levels of unemployment persist, it may signal that reforms are failing to encourage sufficient investment.

In any event, the personal costs associated with unemployment have to be addressed, and in fact every government in Eastern Europe has begun to address the problem. Poland and Yugoslavia, at the republic level, already have unemployment insurance schemes in place.

So does the CSFR, and it is currently considering how to extend and strengthen present arrangements under a structural adjustment loan from the World Bank. Hungary, Bulgaria and Romania are now contemplating legislation to address the problem (Box 3).

Measured unemployment rates are rising quite sharply in the region. Because state enterprises had a strong incentive to hoard labor, like other inputs, disguised unemployment was rampant. It is now becoming less common and, as untenable state enterprises are closed, or viable ones are streamlined, open unemployment is increasing. Still, in due course as the reform programs take hold, employment in the private sector should increase. Moreover, the workforce should become more productive than before.

Progress to Date

Viewed against the practices and policies of the past 40 years, the steps that have thus far been taken toward establishing a market-based economic system are extraordinary. Viewed against what must be achieved to reap the full benefits of reform, a more sober assessment is appropriate. What can be said is that, in most of the countries of the region, a substantive start has been made, although progress is uneven. Hungary, Poland and Yugoslavia have already implemented sweeping reform programs; the reforms in the CSFR are now underway; Bulgaria and Romania, which both have recently adopted IMF programs, are just beginning.

While Hungary's external sector performance has been laudatory and its fiscal reforms have begun in earnest, inflation remains a challenge, and the government still has to address the housing-subsidy program. Although it is too soon to draw definitive conclusions about the Polish reforms, there are some encouraging signs. For example, the hyperinflation at the beginning of 1990, when the annual rate was temporarily over 100,000 percent, decreased dramatically; in six months, it fell to 60 percent. The exchange rate set at the beginning of the year was maintained throughout the year, despite the simultaneous move to internal convertibility.

Box 3: Hungary's Social Security System

Hungary has made a substantial effort to strengthen its protection for the unemployed. Its first full-blown unemployment benefits system was introduced in early 1989, but that was widely criticized, and a new proposal has been tabled in the parliament.

This draft legislation would cover some new entrants, who were previously excluded. And it would be more generous than the previous system for the middle class unemployed; the cap on benefits has been lifted from three to four times the minimum wage. A flat-rate benefit was considered and rejected, despite its administrative simplicity and egalitarian appeal.

But benefits are not indexed for inflation, which adds to the urgency of bringing inflation thoroughly under control. And the scheme will not help the long-term unemployed. They and some new entrants who will not qualify will have to depend on rudimentary local government programs for the poor.

How serious either problem will be no one knows. Even the current extent of unemployment is not fully known. Hungary conducted its first sample labor force survey only at the beginning of 1991.

It is too early to say how the system will perform or what the fiscal impact will be in the early years. No external financing has been sought or offered, and none may be needed. The unemployment benefits are intended to be financed with employee and employer contributions equal to 4 percent of the wage bill. But that may be asking a lot, inasmuch as contributions to the pension and family allowance systems already create a wedge between what employees receive (after taxes) and employers pay, equal to 33 percent of the wage bill.

Still, the scheme is receiving indirect support from the World Bank's first and second Structural Adjustment Loans which aim, among other things, to provide support to a range of social program reforms, particularly to the pension system and family allowance system. These both need urgent reform because they account for a high proportion of current social security contributions by employers and employees.

Source: Discussions with World Bank staff and other multilateral agency staff.

The initial results of the Yugoslav program in 1990 were also encouraging. The rate of inflation, which was 27,000 percent in December 1989, declined until it was negative in June 1990, and foreign exchange reserves rose sharply. Unfortunately, economic conditions deteriorated in the second half of the year, in part because of the worsening political situation.

The CSFR's reforms through the end of 1990 were devoted mainly to setting up the institutional framework, including creating a new central bank and banking system, providing equal status between private and state enterprises, and allowing for full foreign ownership of CSFR enterprises. But since then, the federal government has started a sweeping program of reform (Box 4).

Bulgaria has been enacting reform measures since 1986, but the Bulgarian Socialist Party has been reluctant to relinquish ultimate control of the economy. Previous reform efforts were not fully implemented, which has led some to cast doubt on the prospects of the latest round of reforms. But the political struggles that delayed the implementation of past reforms has sparked such popular unrest that there is now a new political urgency to taking reform seriously. In February 1991, the government, supported by an IMF stand-by arrangement of about $394 million, adopted a far-reaching stabilization and reform program, which seems promising.

Romania's economy remains centrally controlled. The government started down the road to reform by developing a comprehensive program and presenting it to the parliament in the latter half of 1990. Since then, several reformers have been brought in to key positions in government in the Ministries of Finance, Economic Orientation and Privatization, and an adjustment program has been adopted with IMF support. But much remains to be done to reform the greater part of the economic bureaucracy, which remains as it was under Ceausescu, and to define an appropriate program of comprehensive reform.

Prospects

The systemic reform programs now underway in Hungary, Poland,

Box 4: The CSFR's Program

On January 1, 1991, the CSFR government launched several reform initiatives:

- Freeing almost all wholesale and retail prices;
- Liberalizing most of foreign trade and currency exchange procedures applicable to companies;
- Targeting a surplus in the national budget of one percent of the CSFR's GDP;
- Standardizing the commercial and tourist exchange rate and pegging it to a currency basket, not ruling out periodic devaluations if they prove necessary to maintain competitiveness;
- Tightening the money supply and limiting wage increases below price increases, to curb inflation; and
- Starting the privatization program, with restitutions, small-enterprise sales and large-scale privatizations.

The Czechoslovak government began the small enterprise sales on January 26, 1991, with the auction of 20 small businesses in Prague's city hall. Proceeds from the auction equaled 22 million crowns, against reserve prices that totaled 2.1 million crowns, an impressive beginning.

Source: Based on Deutsche Bank Economics Department, *Focus Eastern Europe: Economic Reform and Privatization in Czechoslovakia, 1991.*

the CSFR and Yugoslavia, as well as the ones just beginning in Bulgaria and Romania, will require some time to accomplish their main objectives. The efforts to improve the citizens' well-being by creating self-sustaining economic growth will inevitably be painful in the near term. Many workers face unemployment, a new experience for the generation born after World War II. Moreover, even if the reforms ultimately succeed, not everyone's living standards will improve. There will be winners and losers. As these factors become increasingly evident, they will produce pressures to slow — or even stop — the reform process.

There are signs that reform is losing some of its initial popularity. In Hungary, for example, the increase in fuel prices last fall led to strikes that sharply disrupted economic activity. In last year's national elections in Poland, an unknown candidate making vague promises of prosperity received more votes than Prime Minister Mazowiecki, whose name was associated with the reform program. The threat to the Yugoslav program is particularly grave. There, the political tensions between different ethnic groups and republics have paralyzed economic policy. For the governments that overcome these difficulties and continue down the reform path, however, the prospects for systemic transformation are promising. In an interview in November 1990 for the Polish newspaper *Polityka*, Poland's Minister of Finance Leszek Balcerowicz spoke of the historic challenges his country faces:

> There are no risk-free decisions at turning points in history. Avoidance of socially difficult decisions, in the short run, would mean drafting a program which would not improve anything in our economy, but would create an even greater risk of social discontent in the long run.
>
> We are in the middle of a big exam, an exam of the pass-or-fail kind. Of course, there exist democratic countries in which the so-called political cycle occurs, with politicians opportunistically making concessions in order to win votes. We in Poland cannot afford this, because we face a turning point in history and terrific challenges. If we do not cope with these challenges, we shall forfeit the great opportunity given us recently of freely determining our collective life. And then we can blame only ourselves.

3. Financing the Transformation

This combination of discouraging external circumstances and recent declines in output constituted the background for the Study Group's effort to analyze and assess the future needs of each of the six countries of the region for external finance and assistance.

The framework for this assessment is a quantitative one. But that is not its only dimension, because the characteristics of different financial flows are quite as important as their size. Strategically placed official assistance can be worth far more than its dollar value would suggest. Private direct foreign investments, which help transfer technology and business practices, can involve quite small sums of money and have widespread demonstration effects. And private equity inflows and public grant assistance are preferable to loans — public or private — because they do not increase the external debt burden of the recipient country.

One major caveat to our quantitative analysis is in order. Conditions have changed so dramatically in Eastern Europe and are subject to such continuing rapid change, both domestically and externally, that projections and extrapolations based on previous trends and experiences are extremely difficult to make with any sense of comfort. Structural change creates discontinuities. Even the direction of change is uncertain for many economic variables. So extending the analysis out to 1995 — which was considered necessary to consider prospective shifts in financing patterns — inevitably involves some profound assumptions about the future.

Nevertheless, a quantitative framework is a necessary evil. An overall assessment of the situation could not be made without constructing scenarios of economic growth, balance of payments flows and overall financing patterns. A reasonable degree of confidence in the orders of magnitude developed here is justified, and their broad implications deserve to be taken seriously, even by those who might question particular assumptions and aspects of the method.

The Analytical Approach

A so-called "one-gap" model was used in two steps for the quantitative analysis. In the first step, preliminary judgments about the prospects for growth, the terms of trade, the relationships between economic growth and trade flows, and the availability and terms of finance were made to estimate a financing gap — a deficit of expected uses for external financing over expected sources — in each country in the region. The second step was to close that gap by weighing the various initial independent assumptions and adjusting them to make them consistent.

There is a well known two-gap model used for this kind of analysis, which explicitly takes into account the gap that can arise between domestic savings and investment along certain paths of economic growth. Financial inflows — foreign savings — can fill this gap while they finance a current account deficit. A two-gap model pieces together the domestic and the international parts of an economy into a consistent whole.

This approach was considered initially but was soon rejected, because of the inherent difficulty of assessing the size of future differences between domestic savings and investment. They are both at quite high rates now throughout the six countries of the region. It is possible that savings rates might fall if, for example, import liberalization led consumers to spend more on industrial country goods. But savings rates may rise instead, as loss-making public sector enterprises close, budgetary deficits are reduced, and households raise their precautionary savings in the face of the uncertainties created by structural change. On balance, domestic savings seem unlikely to constrain growth if any improvements can be made in the efficiency of intermediation from savings to investors and in the quality of investment decisions.

The discussion of the main scenario generated by this one-gap two-step analysis determines the structure of the rest of this chapter. First, the prospects for growth inside and outside the region and their implications for trade are considered. Possible sources of finance, private and official, are then reviewed. This is followed by a review of the outlook for debt and for debt servicing, which — together with the outlook for trade — establishes what is characterized as the "baseline scenario" of future external financing. Some of the assumptions on which the baseline scenario is founded are discussed in Annex 1.

Overall, the baseline scenario suggests that real economic growth may resume only after a rather lengthy period of contraction. The chapter continues, therefore, by reviewing how, in an alternative scenario, the resumption of growth might be hastened. This depends on accelerating domestic reforms, which should not only raise growth rates, but also increase absorptive capacity for external financing. While it would increase financing needs, it should also attract more financial inflows. The gains — in terms of faster growth and increased foreign financing — that accompany accelerated reform may be quite substantial. This alternative is characterized as the "accelerated reform" scenario.

Reform and Growth

The implications of reform for growth over the next five years depend critically on the external environment. What will happen to the economies of both the industrial countries and of the Soviet Union over that period?

External Conditions

During the first year of the new decade, the outlook for the industrial countries' economies took a definite turn for the worse. In the weeks that followed Iraq's invasion of Kuwait, the price of crude oil skyrocketed to

$40 a barrel. Crude availability in Eastern Europe suffered a setback because of the embargo on oil from Iraq and Kuwait, which had been sources of growing importance. The Anglo-Saxon economies went into recession, and growth slowed in the industrial economies of Continental Europe. In Germany, progress in reconstructing the former GDR was slower and costlier than expected, absorbing attention and resources that might otherwise have been available to help the six core countries.

Since then, however, the outlook has improved. The oil price rise was quickly reversed, and the Gulf Crisis and war were quickly ended. The post-war reconstruction program may fractionally stimulate the beleaguered construction industries of the industrial countries. With luck, the recession in the United States will be short and mild.

With these recent changes in fortune, the outlook for 1991 as a whole remains uncertain. If the worst of the Anglo-Saxon countries' recession is behind us, the growth rate of the industrial country economies might rise in 1991, compared with 1990. However, if the recovery is postponed and the other industrial country economies slow sufficiently, then growth in 1991 might be less than it was last year. Looking further ahead, there is less reason to be so cautious, and the working assumption in this report is that economic growth will resume at a rate close to the trend of the past few years (Table 7, line 1).

The price of oil, which is settled in world markets, also has a strong determining effect on the outlook for the six countries of the region. As a price that is heavily influenced by a cartel with quite disparate economic and political interests, it would be difficult to forecast five years out at the best of times. Now, in the aftermath of a war among the cartel's leading members, with several of the world's largest oil fields out of commission for an indefinite period, with recommissioned capacity on-stream in Saudi Arabia and with long-standing quota arrangements among producers unsettled, it is almost impossible to say what the trend in the price will be. The working assumption here is that it will hold at about $20 per barrel in nominal terms.

The other external circumstance vital to the region is the economic future of the Soviet Union. The collapse there will hurt Eastern European economic prospects in several ways:

Table 7: Baseline Scenario for Growth Abroad
(*Real GNP; percent change per annum*)

	1990	*1991*	*1992*	*1993*	*1994*	*1995–*
G-5 Growth	2.1	1.5 – 2.5	2.5 – 3.0	2.5 – 3.0	2.5 – 3.0	2.5 – 3.0
Soviet Growth	-0.2 – -15.0	-10.0 – -5.0	-10.0 – -5.0	0.0 – 4.0	2.0 – 4.0	0.0 – 4.0

Note: The "G-5" are the United States, Germany, France, Japan and the United Kingdom and are taken to be representative of the industrial countries as a whole in the quantitative analysis.
Source: Study Group Secretariat estimates.

- Oil exports, vital to the economies of the six countries of the region, will likely decline sharply (Box 5). It is not assumed, however, in the quantitative analysis, that an oil shortage becomes a binding constraint on growth.
- The volume of Soviet imports of all kinds will decline, and East European machine tool sales might fall farther than average as the Soviet Union seeks to postpone all the imports it can. Trade volume declines of over 50 percent in 1991 are expected in some quarters, and they could easily cost the Six between 1 percent and 4 percent of GNP in the next three years.
- Political uncertainties in the Soviet Union will make Eastern Europe a less attractive destination for private capital from the industrial countries.

The difficulties facing the Soviet Union are so profound that it seems likely its economy will contract sharply in 1991 and that the decline will continue in 1992. With luck, the economic situation will reach some kind of equilibrium in 1993, and growth can resume thereafter (Table 7).

Domestic Growth

These international strains have direct implications for growth in the six countries of the region. Equally, the dislocations associated with the domestic reform programs are a drag on economic prospects. The baseline scenario in this report suggests that all the economies of the region will contract in 1991 (Table 8). For 1992, it would indicate a

Box 5. Oil

The rise in the cost of Soviet oil in January 1991, as a result of disbanding the CMEA arrangements and going to world prices, could have been far worse if the oil shock of August 1990 had been sustained. Nevertheless, it will be severe. Oil import prices for the six countries of the region are, effectively, almost three times higher than they were just last year. This has affected other energy costs. Price rises on any cross-border sales are likely to be comparable. But increases in prices of locally produced types of energy have not been as large. For example, Poland's domestic coal and natural gas account for over 50 percent of total energy used. Natural gas for domestic users has sold at 20 percent of world prices, whereas industrial users paid 66 percent.

Prices should increase to reflect opportunity costs more accurately and to encourage efficiency. If they do, the shock will be especially serious for the many enterprises with old, energy-intensive technologies. Some of these, especially those that would have been uneconomic at the old energy prices, will now become urgent candidates for closure unless there are cost-effective ways to convert the technology. But there should also be many opportunities to invest to save energy in such energy-wasting economies.

Will oil be in short supply in the next year or two? Soviet oil exports, the main traditional source of oil supplies for the Six, are expected to fall 30 percent in 1991 and, possibly, by another 30 percent in 1992. Local bottlenecks are foreseen, transportation costs may become significant and long-term investment is needed to improve both oil distribution and refinery versatility. But oil from other parts of the world can reach Eastern Europe, and oil supplies should not constrain economic activity anywhere, with the possible exception of the CSFR.

Source: Discussions with Study Group members and staff.

continued contraction in four of the six economies: Bulgaria, because of its close Soviet ties and late start on reform; the CSFR, as its far-reaching reforms take hold; Romania, because of the extent of the economic reorganization that lies ahead; and Yugoslavia, because of its political

Table 8. Baseline Scenario for Regional Growth
(Real GNP; percent change per annum)

	1989	*1990*	*1991*	*1992*	*1993*	*1994*	*1995*
Bulgaria	-0.3	-11.3	-14.0	-6.7	0.6	0.8	3.0
CSFR	1.0	-3.0	-5.7	-4.8	-3.9	4.3	4.1
Hungary	-1.8	-5.6	-3.1	-0.4	1.5	2.7	3.0
Poland	-0.5	-13.0	-0.2	1.6	2.6	1.8	3.2
Romania	-7.5	-10.5	-6.6	-5.1	-3.9	2.6	4.2
Yugoslavia	0.8	-6.0	-4.9	-2.6	-1.0	-0.5	0.8

Source: Study Group Secretariat estimates.

problems and the peculiar difficulties it faces in restructuring a collectivized economy across disparate republics. Only in 1995 does the baseline scenario show positive real growth in all the countries in the region.

The consensus on regional growth prospects has been falling over the past 12 months, as the gravity of the various difficulties the region faces has been repeatedly reassessed, but it is probably fair to say that the baseline scenario here is more gloomy than typical.

The fundamental reasons for such a somber outlook in the near term are that external developments and prospects are not propitious and that the task of domestic restructuring is an enormous one. If this scenario seems too pessimistic, it must be borne in mind that between 60 percent and 90 percent of the national economies of the region are in the state sector and that 5 to 10 percent of GNP has been spent on defense in recent years. Restructuring means the closure of unproductive plants, of which there will certainly be many. This will have negative short-term effects on suppliers, which will multiply the negative impact on demand. In addition, stabilization programs will call for sharply lower budget deficits throughout the region, which will be contractionary. And tight monetary policies will be needed to hold inflation in check when major relative price changes combine with wage demands to put upward pressure on the price level. It would be surprising if the impact of restructuring and stabilization on aggregate demand and growth over the next two or three years were not severe.

Still, future economic prospects are especially difficult to gauge at the moment. While it is clear that the old system was wasteful and inefficient, the extent of waste and inefficiency is not yet known. It follows that gauging potential gains from increased efficiency is more art than science. It is worth underlining that *the numbers put forward here are illustrative of general trends rather than anything approaching a conventional economic forecast.*

Assessing Trade Prospects

Given this tentative outlook for growth inside and outside the region, it is possible to say something about the prospects for trade, the first step in assessing financing needs.

Exports of goods and services to the industrial countries are assumed to rise quite rapidly in the baseline scenario. The region's very small share in industrial country imports would rise about 50 percent a year. This means, for example, 2 percent real growth in the industrial countries would result in about 7 percent growth in real exports. Such rapid growth would seem both desirable and feasible, provided East European goods have adequate access to industrial country markets — a matter of great importance to the prospects of the region (Box 6).

Exports and imports of goods and services to the Soviet Union are assumed to correlate with Soviet GNP, except in 1991, when they are expected to fall 20 percent in nominal terms, reflecting an expected sharp drop in Soviet GNP and some additional disruption in trading relationships (Table 9). Early indications are that the drop in 1991 trade volumes with the Soviet Union might exceed even this pessimistic figure.

In general, every effort should be made to stimulate export growth. Export-oriented economic development strategies have been proven effective time and again in the past 30 years, and there is no reason to think that the transformation of Eastern Europe would not benefit equally from such an open orientation.

In the short term, this may present a particular financing problem, at least so far as capital goods exports are concerned. With the dissolution of the CMEA, exports within the region and from Eastern Europe to the

Box 6. Agricultural Trade

The most important aid that industrial country governments can offer the region is improved access to their markets. In particular, there are many categories of agricultural products for which Eastern Europe has a comparative advantage: meat and meat products; fresh and processed fruits and vegetables. In recent years, regional agricultural exports amounted to about $7 billion, of which about one-third was sold to the industrial countries. Most of the remainder went to the Soviet Union under bilateral agreements.

But Soviet markets have stagnated. Most export growth will have to come from the industrial country markets — notably, the European Community (EC). In 1988, the EC imported only $2 billion of agricultural products from the region. If East European agricultural exports could reach about $20 billion (in 1988 prices) by the end of the century, as some experts predict, could the EC absorb something over half?

It would be very difficult. The agricultural reform proposals currently under discussion within the EC may fall short of what the East European countries need. "Associated status" in the European Community, which Poland, Hungary and the CSFR should pursue, would provide much-needed improved access for manufactured goods but would not guarantee improved access for agricultural goods. In these circumstances, any increase in agricultural market access — that is not offset by increased subsidies for EC exports into the Soviet Union — would be most welcome.

Source: Based on a paper by Fred H. Sanderson, Senior Fellow at the National Center for Food and Agricultural Policy, at Resources for the Future, Washington, DC.

Soviet Union must now be promptly paid for with hard currency, putting the exporters at a serious competitive disadvantage against industrial country competitors with access to export credits. For the next few years, there is a convincing case for industrial country assistance to offset this potential disadvantage (Box 7).

In the baseline scenario, imports of goods and services (excluding

Table 9. Baseline Scenario for Trade
(US$ billions)

	1991	*1992*	*1993*	*1994*	*1995*
Bulgaria					
Trade Balance	-1.1	-0.8	-1.0	-0.9	-0.9
Exports	6.7	6.5	6.8	7.5	8.3
To USSR	4.3	3.9	4.0	4.3	4.7
Imports	7.8	7.2	7.8	8.4	9.2
From USSR	4.6	4.1	4.2	4.4	4.8
Poland					
Trade Balance	0.5	0.7	-0.3	-0.3	0.0
Exports	17.2	17.9	19.3	21.3	23.5
To USSR	3.4	3.1	3.1	3.4	3.7
Imports	16.7	17.2	19.6	21.6	23.5
From USSR	4.5	4.4	4.6	4.9	5.3
CSFR					
Trade Balance	-1.7	-1.4	-0.6	-0.7	-0.3
Exports	11.3	11.7	12.8	14.5	16.4
To USSR	2.9	2.7	2.7	2.9	3.1
Imports	13.0	13.1	13.5	15.2	16.7
From USSR	5.3	4.9	4.9	5.3	5.7
Romania					
Trade Balance	-1.9	-1.7	-0.8	-1.1	-0.6
Exports	5.6	5.8	6.6	7.5	8.5
To USSR	1.1	1.0	1.0	1.1	1.2
Imports	7.5	7.5	7.4	8.6	9.1
From USSR	2.4	2.1	2.1	2.2	2.5
Hungary					
Trade Balance	0.5	0.9	1.2	1.1	2.1
Exports	13.0	13.9	15.2	17.4	19.9
To USSR	2.2	2.0	2.0	2.2	2.4
Imports	12.4	13.1	14.0	16.3	17.8
From USSR	3.9	3.8	4.0	4.5	4.9

Table 9. Baseline Scenario for Trade *(continued)*
(US$ billions)

	1991	*1992*	*1993*	*1994*	*1995*
Yugoslavia					
Trade Balance	-0.2	-0.3	0.9	0.5	0.4
Exports	20.0	21.3	23.5	26.2	28.8
to USSR	1.1	1.0	1.0	1.1	1.2
Imports	20.2	21.6	22.6	25.7	28.4
from USSR	1.7	1.5	1.5	1.6	1.7
Regional Total					
Trade Balance	-3.8	-2.6	-0.5	-1.3	0.7
Exports	73.8	77.1	84.3	94.5	105.3
to USSR	15.0	13.8	13.8	14.9	16.2
Imports	77.7	79.7	84.8	95.8	104.6
from USSR	22.4	20.8	21.3	22.9	24.9

Source: Study Group Secretariat estimates.

interest payments and fuel imports) from the industrial countries are assumed to rise as a percent of GNP. Indeed, the scenario shows imports rising in nominal terms throughout the forecast period, lifted initially by import liberalization and then by the resumption of growth. Non-fuel imports from the Soviet Union are expected to rise only as fast as GNP in the six countries of the region, reflecting some continuing substitution of Soviet goods with goods from the industrial countries. Oil and natural gas imports are forecast to decline and then increase in parallel with real GNP in the Six. Because energy use usually rises faster than GNP, this assumption reflects anticipated conservation efforts.

Financing Sources

Given this baseline scenario for growth and trade, what are the prospects for external financing?

To begin with a caveat, there is some danger that the East European governments may anticipate unrealistically high levels of external finan-

Box 7. Export Finance for the Region

Trade among the six countries of the region, and between them and the Soviet Union, is expected to decline substantially in 1991. In addition to the disruptions caused by the dissolution of the barter-based trading system of the CMEA and the decline in Soviet economic activity, the Six are expected to face stiff industrial country competition in their traditional CMEA markets.

Over the next few years, odds are that some of these sales will be won by industrial country firms by virtue of access to export finance. Industrial country export credit agencies provide $6 billion annually in financing for exports to Eastern Europe and the Soviet Union. Industrial country firms can offer financing, whereas regional suppliers will now have to demand immediate cash payment.

Two members of the Study Group, Daniel Bond, who is Vice President of the United States Export-Import Bank, and Anthony Solomon, who is Chairman of the Institute for East-West Studies Program on the Soviet and East-Central European Economic Transition, have suggested that the industrial countries help level the playing field by setting up a facility for East European export financing. They propose that it be managed by a multinational institution, such as the European Investment Bank or the European Bank for Reconstruction and Development (EBRD). East

cial assistance, for two main reasons. First, there have been the much publicized inflows of capital into the former GDR. Quite aside from official assistance of some DM 100 billion (about $65 billion) in 1990 and earmarked flows of DM 120-130 billion (about $80-$90 billion) in 1991, significant private inflows have been announced — notwithstanding the recent disappointments with the rate of progress with the transformation of East Germany's economy. Second, as discussed below, commitments of finance are often multi-year, and the numbers cited in public sources often refer to total project costs rather than foreign exchange inflows.

Table 10 summarizes the baseline scenario for financing sources.

European governments would guarantee industrial country commercial bank loans to their national export credit agencies in the region, and the facility would be used to reinsure the national guarantees.

They estimate that annual demand for export credit reinsurance might soon reach $4 billion a year. To cover claims, the reinsurance facility would need to be backed by reserves of about one-tenth the size of outstanding guarantees. If there were a five-year average repayment period, reserves would have to grow to about $2 billion. These reserves could be funded by premiums charged by participating export credit agencies as well as official assistance from the industrial countries. The terms would not be more generous than those offered by Western export credit agencies to their own exporters or cover uncreditworthy transactions and would favor private firms. The program would be phased out as East European governments become able to finance these operations on their own.

This initial Western assistance could help Eastern Europe cope with the current disruption in trade, to the extent that it is the result of a lack of financing, and help it move quickly into the normal multilateral practice of world trade and finance.

Source: Discussions with Study Group members.

Based on the analysis that follows, the table summarizes the outlook for private sector financing, official financing and debt reduction.

The Private Sector

Table 11 summarizes the private sector financial inflows assumed in the baseline scenario. Total inflows would rise from $23 billion in 1991 to $39 billion in 1995. Disbursements of short term loans are forecast to rise in nominal terms by just over one half — from $19 billion in 1991 to $30 billion in 1995.

Two points should be made about these short-term flows. First, they

Table 10. Baseline Scenario for Financing Sources
(US$ billions)

	1991	*1992*	*1993*	*1991*	*1995*	*1991-1995*
Bulgaria						
Total	5.0	4.4	4.8	4.8	5.0	24.1
Private Sector Financing	1.4	1.6	1.9	1.8	1.7	8.5
Official Financing	0.8	0.7	0.7	0.8	1.0	4.1
Assumed Debt Relief	2.8	2.1	2.2	2.2	2.3	11.6
CSFR						
Total	6.6	8.5	9.6	10.7	11.5	46.7
Private Sector Financing	4.6	6.5	7.5	8.2	8.6	35.3
Official Financing	2.0	2.0	2.1	2.5	2.9	11.5
Assumed Debt Relief	0.0	0.0	0.0	0.0	0.0	0.0
Hungary						
Total	8.0	8.0	8.8	9.6	11.4	45.9
Private Sector Financing	5.0	6.1	6.7	7.1	8.4	33.4
Official Financing	3.0	1.9	2.1	2.5	3.0	12.6
Assumed Debt Relief	0.0	0.0	0.0	0.0	0.0	0.0
Poland						
Total	8.5	10.2	11.0	11.1	11.8	52.7
Private Sector Financing	3.2	3.4	3.9	4.6	5.1	20.1
Official Financing	2.5	1.7	1.9	2.0	2.3	10.3
Assumed Debt Relief	2.9	5.1	5.2	4.6	4.5	22.3

Table 10. Baseline Scenario for Financing Sources *(continued)*
(US$ billions)

	1991	*1992*	*1993*	*1991*	*1995*	*1991-1995*
Romania						
Total	2.5	3.5	3.9	4.7	5.1	19.7
Private Sector Financing	1.2	2.4	2.5	3.2	3.4	12.7
Official Financing	1.3	1.1	1.4	1.5	1.7	7.1
Assumed Debt Relief	0.0	0.0	0.0	0.0	0.0	0.0
Yugoslavia						
Total	7.7	9.0	9.5	10.5	11.7	48.2
Private Sector Financing	6.4	7.8	8.3	9.2	10.2	41.8
Official Financing	1.3	1.2	1.2	1.3	1.5	6.4
Assumed Debt Relief	0.0	0.0	0.0	0.0	0.0	0.0
Regional Total						
Total	38.3	43.5	47.6	51.6	56.5	237.5
Private Sector Financing	21.7	27.8	30.8	34.2	37.2	151.7
Official Financing	10.9	8.4	9.4	10.6	12.5	51.8
Assumed Debt Relief	5.7	7.3	7.4	6.8	6.7	33.9

Source: Study Group Secretariat estimates.

are large in relation to the long-term debt disbursements in this baseline scenario. But it should be remembered that most of them will be repaid within a matter of months, and, by definition, all short-term debt is repaid within a year. To be consistent, the large amortization figures discussed later in this chapter in the context of the use of external funds reflect similarly large repayments of short-term debt. Second, although the figures on short-term debt refer to financing that would largely

Table 11. Baseline Scenario for Private Sector Financing
(US$ billions)

	1991	*1992*	*1993*	*1994*	*1995*	*1991-1995*
Bulgaria						
Total	1.4	1.6	1.9	1.8	1.7	8.5
Short-Term Debt Financing	1.3	1.5	1.7	1.6	1.4	7.5
Long-Term Debt Financing	0.1	0.1	0.1	0.1	0.1	0.4
Equity Financing	0.0	0.1	0.1	0.2	0.2	0.6
CSFR						
Total	4.6	6.5	7.5	8.2	8.6	35.3
Short-Term Debt Financing	4.1	5.3	6.0	6.4	6.4	28.3
Long-Term Debt Financing	0.4	0.9	1.2	1.4	1.7	5.6
Equity Financing	0.1	0.3	0.3	0.4	0.4	1.4
Hungary						
Total	5.0	6.1	6.7	7.1	8.4	33.4
Short-Term Debt Financing	4.0	4.6	4.8	4.9	5.7	24.0
Long-Term Debt Financing	0.7	0.8	1.0	1.3	1.6	5.4
Equity Financing	0.4	0.7	0.8	1.0	1.1	4.0
Poland						
Total	3.2	3.4	3.9	4.6	5.1	20.1
Short-Term Debt Financing	3.0	3.1	3.6	4.1	4.5	18.3
Long-Term Debt Financing	0.1	0.1	0.1	0.2	0.3	0.7
Equity Financing	0.1	0.2	0.2	0.3	0.3	1.1
Romania						
Total	1.2	2.4	2.5	3.2	3.4	12.7
Short-Term Debt Financing	1.2	2.2	2.3	2.7	2.9	11.3
Long-Term Debt Financing	0.0	0.1	0.2	0.3	0.3	0.9
Equity Financing	0.0	0.1	0.1	0.1	0.2	0.5
Yugoslavia						
Total	6.4	7.8	8.3	9.2	10.2	41.8
Short-Term Debt Financing	5.6	7.0	7.3	8.2	9.0	37.0
Long-Term Debt Financing	0.5	0.6	0.7	0.8	0.9	3.4
Equity Financing	0.3	0.3	0.3	0.3	0.3	1.4

Table 11. Baseline Scenario for Private Sector Financing *(continued)*
(US$ billions)

	1991	*1992*	*1993*	*1994*	*1995*	*1991-1995*
Regional Total						
Total	22.6	29.4	32.4	35.5	38.5	158.4
Short-Term Debt Financing	19.1	23.7	25.7	27.9	29.9	126.3
Long-Term Debt Financing	1.7	2.5	3.2	4.1	4.9	16.4
Equity Financing	0.9	1.6	1.8	2.2	2.3	8.9

Source: Study Group Secretariat estimates.

originate in the private sector, most of it will be extended only with official guarantees of some sort. For example, over the next five years, the great bulk of commercial bank finance for imports from the industrial countries will be forthcoming only with export credit guarantees. Moreover, a fraction may be official credits, offered independently of any private financing source, directly from aid resources. To that extent, the totals discussed here are not all strictly private financial flows.

Long-term debt financing to the region would rise from just under $2 billion to roughly $5 billion between 1991 and 1995 in this baseline scenario. This comprises disbursements of long-term loans and debt financings arranged in international capital markets or in private placements. In addition, there is equity financing, which comprises financing flows associated with direct foreign investment and different types of non-controlling interest that foreign investors may take in enterprises in the region. In the baseline scenario, these equity financings would increase from roughly $1 billion to just over $2.3 billion between 1991 and 1995.

Bank Lending. So far as short-term bank lending is concerned, it is reasonable to assume for most of the countries in the region that there will be a fairly stable relationship between trade growth and disbursements. Much short-term lending is trade related and secured by goods in transit as well as official guarantees. Although in the near term, trade relations and arrangements among the Six and between them and the Soviet Union may be so uncertain that trade growth is inhibited, there is no reason to think that trade with the West will be materially affected, and it is primarily this trade that forms the basis of the forecast on short-term financing in the baseline scenario.

Disbursements of medium- and long-term loans from private commercial sources, primarily Western banks, are also assumed to rise over the next five years, but by very modest amounts. Discussions with bankers from several countries indicate that, in the first instance, they are very reluctant to extend medium- and long-term sovereign credit to the region. Given their particular debt-servicing problems, a reluctance to lend is easily understood in the cases of Poland and Bulgaria. But why should it extend to the other countries in the region? The view appears to be that none of them is in a strong enough position to undertake much increase in sovereign lending. Many banks appear to see covariance in sovereign risk among the Six. Moreover, because of the credit constraints that now exist for most of the major lending banks, there is a general reluctance to extend sovereign credits to any but the highest-rated industrial countries. This, in turn, is a function of the difficult experience that so many banks had with international lending in the 1980s.

Nonetheless, there will be individual exceptions where particular institutions, especially in Western Europe, have strategic reasons for making sovereign loans to particular countries — perhaps, for example, Austrian banks will feel the need to do some sovereign lending to Hungary at some point over the next few years — but it is unlikely that many institutions will follow their lead. And bank lending for projects in Eastern Europe will grow as the banks' established Western industrial clients find investment opportunities there. Most bankers are quite open to considering medium- or long-term financing in conjunction with direct foreign investment by clients who are interested in the region.

In addition, indications are that there will be interest in lending in parallel and joint financing arrangements with official sources, for projects that are developed in conjunction with Western governments and the multilateral agencies. The presence of official financing sources seems likely to provide a high degree of comfort and serve as a key catalyst to private sector lending into the region, as it has in other parts of the world.

And, of course, banks are prepared to lend where credits are guaranteed by the industrial countries' export credit agencies. These agencies report that, although substantial lines of credit have been opened for lending to Eastern Europe, they have not been used extensively by Western banks, suggesting a dearth of bankable investments and, perhaps, a bottleneck in the identification and appraisal of suitable schemes. Box 8, which describes the IFC's program, notes how that institution is finding progress slower than anticipated on this account.

Finally, it is worth noting that the scope for bank lending will increase as countries permit foreign banks to engage in local operations. There may be a limited direct relationship, but there is no doubt that the resulting greater familiarity of foreign banks with local business conditions and the experience that they build up locally can contribute significantly to the confidence they must have before expanding cross-border lending to a significant extent.

Capital Markets. In addition to commercial bank lending, another important source of external finance may be the capital markets, where financing is available through security issues — either in the bond markets, in the form of fixed-income securities, or in the equity markets, in the form of shares. Because of the recent isolation of Eastern Europe, access to the international capital markets has been relatively limited in recent years, although Hungary, the CFSR and the Soviet Union have from time to time been able to raise funds abroad in the bond markets.

Bond Markets. The emergence of the international debt problem in the 1980s resulted in constraints not only on commercial bank lending but also on access to the international bond markets. Nonetheless, over the long term, East European countries should be able to tap these markets to help meet their external financing needs, as they develop better credit standings.

Among the six countries, Hungary stands out as a pioneer in bond market finance. As Table 12 indicates, Hungary has been borrowing in

Box 8. The IFC's Program

The IFC now has 11 joint ventures in Hungary; of these five are in the financial sector and six in the industrial sector. All are greenfield. Seven have West European partners and three have Japanese partners. The latest is Hungary's largest joint venture to date: the Suzuki automobile project. In addition, the IFC has created an agency arrangement with a local bank for handling smaller transactions for the IFC's account, both equity and loan, in the private sector. Three or four more operations are on the way, and the IFC is undertaking some specific advisory work on corporate privatizations.

In Poland, the program is equally diversified. Having advised the government on the privatization process as a whole, the IFC is now developing individual transactions. A furniture-maker is the first to be floated in the market by the IFC, although the IFC's first joint venture in a hotel in Warsaw was *de facto* a privatization of a state asset.

The IFC, in consort with the World Bank, is setting up a twinning arrangement between Polish and industrial country banks, to provide technical assistance. Nine such liaisons are anticipated. The IFC has also established an advisory service, to help small businesses develop project proposals for funding. This has been

the capital markets for several years now, and indeed much of its outstanding external debt is in the form of securities. In 1990, Hungarian issuers, primarily the central bank, were able to raise the equivalent of about $950 million in currencies including the US dollar, the DM, the Yen and the Austrian schilling. For 1991, they are planning to raise $1 billion equivalent. If they succeed, the baseline scenario for private sector financing into the region in Table 11 will turn out to be conservative for the current year.

Among the 1990 transactions was an innovative and successful bond issue by the State Development Institute of Hungary for $200 million. The repayment of the principal of the issue is guaranteed by the World Bank, making it the first Eurobond to utilize the World Bank co-financed with grants from the European Community, bilateral donors, as well as from the IFC's own resources. EBRD is to join as a co-sponsor. This advisory service will have offices in Warsaw, Cracow and Gdansk. It hopes to make use of local expertise wherever possible and thereby help build up the local consulting industry.

In the CSFR, the IFC has been discussing the proposed voucher system for privatization. With wide-scale ownership, the danger is that no group of shareholders will be able to shake management out of its old ways. To overcome this, the IFC is considering setting up financial intermediaries that can become active stockholders in privatized ventures. The risk is that establishing intermediaries will take time and might, therefore, delay privatization.

Now that basic reforms are being carried out in the CSFR, the IFC is examining a number of joint ventures and is advising on some specific corporate privatizations, including that of a state-owned bank.

In general, the IFC is finding that progress is slow and, consequently, less money is being disbursed than had been expected.

Source: Discussions with IFC officials.

Table 12. Debt Financing in the International Capital Markets
(US$ million equivalent)

	1981 – 85	*1986*	*1987*	*1988*	*1989*	*1990*	*First Quarter 1991*
Bulgaria	0.0	0.0	0.0	81.8	225.3	0.0	0.0
CSFR	0.0	0.0	0.0	80.0	70.4	433.5	0.0
Hungary	531.3	375.8	551.6	811.3	946.8	949.9	219.4
Poland	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Romania	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Yugoslavia	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total	531.3	375.8	551.6	973.1	1,242.5	1,383.4	219.4

Source: Morgan Stanley database.

Box 9. The Multilateral Institutions: Using Their Guarantee Authority

How can the multilateral agencies use their guarantee authority to leverage their own resources *and* stimulate additional private capital flows into Eastern Europe?

One possibility arises in environmental cleanup projects in an export sector like metal refining. Private lenders from the industrial countries might be willing to finance, say, the installation of scrubbers for smelters and an overall modernization program for metal production. They might require that any associated increases in export receipts be placed in an offshore escrow account and dedicated to servicing the new debt *and* that a commodity swap be used to insulate the project's cash flows from the adverse effects of fluctuating commodity prices. Multilateral guarantees could help in assembling such a finance package. They could take the form of a late maturity guarantee on the underlying project loan and a partial first loss guarantee on the commodity swap. By giving private lenders and export credit agencies the comfort of knowing that multilateral agencies were associated with the project, this package of partial guarantees could attract substantial private capital inflows in return for a relatively modest commitment of multilateral agency capital. The first loss guarantee might be as low as 5 percent and still be an effective catalyst to private financing.

A second innovative use of guarantees might involve forfeiting. This is a form of trade finance that could be especially useful in helping newly privatized entities in Eastern Europe buy capital goods, machinery and spare parts abroad. In a typical forfeiting transaction, a capital goods manufacturer accepts payment in the form of a series of promissory notes, or bills of exchange, issued by the importer. A forfeit company then purchases the bills from the exporter at a discount and sells them to other investors it has lined

financing scheme. Such credit enhancement mechanisms by official agencies like the World Bank or the EBRD could become a valuable tool for the developing the markets for East European borrowers, and should be further encouraged. Box 9 suggests some other innovative ways in up in advance. However, such investors are often unwilling to purchase bills with a maturity of more than two or three years, and many capital goods transactions need longer-term financing to be viable. This is where the multilateral agencies might help. They could stretch out the maturity that such investors would find acceptable by guaranteeing, say, a fourth and fifth year of repayment. Over time, as the investors became more comfortable with the late maturity risks, the need for multilateral guarantees might dissipate, releasing the multilateral agency resources for other uses.

A third way to use guarantees involves utilities, which are often especially vulnerable to changes in government policies. In a power-generating project, for example, foreign investors might worry that in five, 10 or 15 years the government might change rules and regulations about fuel imports, electricity pricing or power purchase agreements in a way that inadvertently undermined the project's financial viability. Multilateral guarantees might reassure private investors. These guarantees might indemnify lenders *if, and only if,* the government reneged on certain well-defined contractual obligations to the utility company. The private lenders could bear all the usual political and commercial risks.

These examples show that, by mitigating risk, multilateral guarantees might help mobilize new private financing and help borrowers build new, potentially self-sustaining bridges into international capital markets. And, equally, they should encourage borrowers to manage their affairs in a commercially viable manner, lest the guarantee be called.

Source: Discussions with World Bank and other multilateral agency staff.

which the multilateral institutions could use their guarantee authority.

As indicated in Table 12, the CSFR has also begun to develop access to the international bond markets, raising over $400 million equivalent in 1990. The other four countries of the region, have not, however, developed any access to the international markets, and their external funding has been primarily in the form of bank or official debt.

In view of the rapidly changing economic and political conditions in the region, access to the bond markets may be difficult to obtain in the immediate future in any significant volume. And, of course, borrowing in the bond markets adds to the debt servicing obligations of the borrower.

Nevertheless, as the reform programs of the Six proceed, as their outstanding debt is properly managed and as their credit worthiness is established in their international financial community, the international bond markets will offer an incremental source of external finance for the future. The amounts available in those markets, and the flexibility afforded by the wide variety of financial instruments that are used in those markets can make them attractive. Now is the time to develop the skills and relationships necessary to approach these markets.

Equity Markets. Because equity ownership has not existed in Eastern Europe in recent history, the use of the international equity markets, or the issuance of shares that might be bought by foreigners, has not been an option for attracting foreign financial inflows. Nevertheless, these methods of external financing should not be overlooked and should be developed for future use. Foreign portfolio investment in domestic enterprises can contribute to the institutional development of domestic equity markets.

Indeed, the process of privatization may be strengthened and accelerated through the development of these countries' access to the international capital markets. Hungary intends to issue convertible bonds in the international markets, permitting the holders to participate in share issues of Hungarian companies as they are privatized. A precedent for such a convertible issue has already been established by the government of Malaysia in connection with the privatization of Telekom Malaysia, and the Hungarian plan is an elaboration of that approach. If successful, this innovative instrument could serve to attract incremental external funding and at the same time support the privatization process in the region. Hungary raised about $120 million equivalent in the international equity markets in 1990 and can now plan more innovative approaches. None of the other countries in the region has yet developed access to those markets.

The forms that equity investments can take vary considerably. They range from a foreign investor buying shares in an East European company directly in the local market, to participation in a country fund, in which pools of foreign capital are raised abroad for investment in shares of several companies in one or more East European countries.

There is potential for rapid growth in portfolio investment, once the process of privatization has moved forward, and shares in domestic companies become available to foreign investors. Both the IFC and the EBRD, which is required to allocate 60 percent of its finance to the private sector, should play a leading role in encouraging future equity inflows (Box 8).

The Polish and Hungarian Enterprise Funds set up with US government backing last year are having some success at placing quite small amounts of foreign capital to work. This suggests that small investors abroad might be attracted into local capital markets if they were better developed. These two Enterprise Funds and the Czech and Slovak Enterprise Fund, which has just been established, must somehow manage economically to appraise small investments. The efficient way to do this would be through banks — something that underlines once more the importance of reforming the financial sector.

These three funds constitute one route through which equity investments can be made in the region at present, but they are unique. Another, more usual route would be the further development of country funds, where the IFC has been playing the leading role. One such fund already in operation is the First Hungarian Fund, with capital of $80 million. Others are being studied.

In general, given the nascent state of the stock markets, accounting standards and reporting requirements, it is not practical to expect foreign investors to buy shares of companies in the region in any substantial amounts, at least in the near term. Over time, however, such investments could be made attractive, and thus their development as a source of external finance should be pursued.

Direct Foreign Investment. Equity instruments in the international markets, portfolio investment, and bond markets are all potentially very important sources of external finance for the East European countries. But, in the near term, direct foreign investment is likely to account for the bulk of private equity capital inflows.

Direct foreign investment in Eastern Europe amounted to $691 million in 1990, up from $355 million in 1989. To realize the baseline scenario for all private equity capital inflows — $0.9 billion in 1991 rising to $2.3 billion in 1995 — direct foreign investment into the region would have to rise by 30 percent in 1991 and to average growth of 20 to 25 percent a year thereafter. Although these are high rates of growth, the scenario still involves quite modest sums, reflecting the low starting point. For the five years 1991 to 1995, taken together, portfolio and direct foreign investment would total just under $9 billion.

Relatively modest totals over the entire period seem warranted, because many impediments to direct foreign investment into the region are likely to persist for a while:

- Commercial law, accounting practices and tax systems are all in flux.
- Property rights are not yet firmly established or protected.
- There are serious pollution and infrastructural problems that make it difficult to do business in the region. Telecommunications are particularly poor.
- Policy issues are unsettled. For example, how will the private sector be required to contribute to environmental cleanup (Box 9)? What kinds of requirements with respect to hard currency earnings, employment levels or other business conditions may be imposed on foreign investors during government negotiations (Table 13)?
- The slow pace of privatization may limit the scope for direct and portfolio investment.

Direct foreign investment may be profitable, but it is difficult to do (Boxes 11 and 12).

Discussions with international companies as well as public report-

Box 10. The Ecological Legacy

Four decades of accelerated industrialization under the Communist regimes in Eastern Europe have transformed major portions of the region into an ecological wasteland. The damage apparently is worst in Poland, where:

- 65 percent of the rivers are thought to be so polluted that industries are reluctant to use the water for fear that it would corrode their machinery, and
- 11 percent of the land area has been declared an area of ecological hazard, while Upper Silesia, Cracow, Rybnik, Legnica-Glogow and Gdansk have officially been declared areas of ecological disaster.

Other areas have also suffered. In Bohemia, for example, power plants and chemical factories produce so much sulfur dioxide that the region receives 127 tons of acid rain per square kilometer every year, in comparison with a national average of 25 tons. Men in the area have an average life expectancy of 52, which is 10 years less than the national average, and one in 10 births are still births. The Hungarian state news agency reports that a one-hour stroll through some of Budapest's most polluted streets is as bad for the lungs as smoking 20 cigarettes.

The costs of correcting the damage will be large. The West German Institute for Economic Research estimates that $200 billion will be needed for environmental (industrial) reforms in the former GDR, Poland, the CSFR and the European part of the Soviet Union. In 1989, the US Congress earmarked $25 million to clean up the environment in Eastern Europe; the bulk of these funds has reportedly been sufficient to end pollution in one set of smokestacks in one industrial plant in Cracow.

Source: U.S. News and World Report, April 30, 1990, and *Our Planet*, Volume 2, 1990, and other official sources.

ing on the region show that a good deal of interest in direct investment in the region has emerged over the past two years. One recent survey (by a major international accounting firm, DRT International) of 128 of clients having more than $1 billion in revenues highlighted this interest

Table 13: Rules Governing Direct Foreign Investment

	Foreign Ownership Provisions	*Management*	*Repatriation of Profits*
Hungary	100% foreign ownership permitted since 1988 .	Foreign senior management and board members permitted.	Profit transfer in hard currency allowed. Conversion of profits into hard currency guaranteed by government.
Poland	Foreign investment agency may allow up to 100% foreign ownership; otherwise, foreign ownership may not exceed 49%.	Senior management must be Polish.	Must sell 15% of annual hard currency profits to Polish foreign trade bank. Balance of hard currency profit remittable. Government can also authorize remittance of Zloty profits.
CSFR	Foreign ownership may not exceed 49%.	Senior management must be Czechoslovakian, though foreign participation in decision-making encouraged.	No clear rules. Foreign currency banks decide on case-by-case basis.
Yugoslavia	Foreign ownership up to 100% permitted.	Joint management by Yugoslavian and foreign partner, in proportion to investment.	Profit transfer in hard currency allowed. Dinar now pegged to the DM.
Romania	Foreign ownership may not exceed 49%.	CEO and board members may be foreign; general manager must be Romanian.	Profit transfer in hard currency allowed.
Bulgaria	Foreign ownership may exceed 50%.	Joint managemnt by Bulgarian and foreign partner is required.	Profit transfer in hard currency is allowed.

Source: International Institute for Finance, *Eastern European Report*, July 9, 1990.

Financing Operations and Loans	*Accounting (Western standards do not apply)*	*Tax Incentives*	*Guarantees*
Joint ventures subject to same laws as Hungarian companies.	Depreciation rates agreed upon by joint venture partner. Must divert 15% of profits into reserve fund of 15% - 20% of equity capital.	Profits taxed at 40% rate. Tax incentives of up to 100% are available if criteria met.	Government does not preclude nationalization expropriation but does guarantee prompt compensation at market value, in currency of investment.
Must have account with Polish foreign trade bank. May maintain foreign bank accounts and obtain credit from Polish or foreign banks.	Same depreciation rates as state enterprises. Must divert up to 10% of profits into reserve fund of 4% of annual operating costs.	Profits taxed at 50% rate. Many tax incentives for joint ventures.	No specific provisions for protection of foreign investment from expropriation or nationalization.
Must have account with domestic foreign currency bank. Need permission for foreign bank accounts. May obtain credits from domestic banks only.	Same depreciation rates as state enterprises. Must create reserve fund and cultural and social, remuneration, and other funds.	Profits taxed at 40% rate. No tax incentives for joint ventures. 25% withholding tax levied on dividends transferred out of country.	No specific provisions for protection of foreign investment from expropriation or nationalization.
Joint ventures subject to same laws as Yugoslavian companies.	Same depreciation rates as state enterprises. New accounting laws with some international accounting standards.	Tax rates about 40%. Tax deductions available during initial investment period and on assets reinvested or deposited in a domestic bank.	No specific provisions for protection of foreign investment from expropriation or nationalization.
Must have account with an authorized Romanian bank. May obtain credits, in convertible currency, from Romanian or foreign banks.	Depreciation rates agreed on by joint venture partner. Must create reserve fund as specified in contract.	Profits taxed at 40% rate. 1-year tax holiday and other reductions negotiable. If profits reinvested for 5 years, 24% tax rate applies.	No specific provisions for protection of foreign investment from expropriation or nationalization.
May hold accounts in Leva and foreign currency. May obtain credits from Bulgarian and foreign banks.	Depreciation rates agreed on by the joint venture partner. Must create reserve fund equal to capital.	Profits taxed at 30% rate. Tax-free zones in which no taxes are paid for the first 5 years and 20% thereafter exist.	In case of expropriation, government guarantees compensation at market value in the currency of investment.

Box 11. Sara Lee

In the middle of 1990, senior Sara Lee executives visited Hungary with a view to investing in what they perceived as the most stable of the emergent democracies in the region. Their initial visits were unpromising and ended in some confusion. They were uncertain about the role of the State Property Agency, the possible restrictions on imports — they wanted to bring in hosiery from Western Europe, in competition with established Hungarian firms — and in general they found it hard to identify the people who could make decisions.

Still, their investment of time and effort has led to a more tangible investment in a Hungarian food company, the Compack Trading and Packing Co., the third largest of its kind in Hungary. Sara Lee now has a 51 percent stake in the company, worth around $60 million, according to the State Privatization Agency, which takes some credit for the deal.

Sara Lee plans to bring to Compack updated production, technical and marketing expertise in addition to a capital infusion. Sara Lee hopes Compack will be an important base for future expansion throughout the region.

In time, this expertise may be the most important contribution Sara Lee makes to Hungary's food industry. In the short term, the deal appears to be atypically front-loaded. That is, much, if not all, of the $60 million is likely to be paid in the first 12 months — having an immediate favorable impact on the balance of payments.

Source: Steve Weiner, "On the Road to Eastern Europe," *Forbes*, December 10, 1990.

(Table 14). Almost 95 percent of the European respondents were planning to invest in Eastern Europe within the next decade. While only 50 percent of the US and 45 percent of the Canadian companies expressed such an intention, that is still quite a high level of interest, considering that the region was so recently closed to direct investment.

Still, the survey indicated only a total of $3.2 billion of investments were under consideration for the next five years. Moreover, it covered

Table 14. Direct Foreign Investment Intentions

	Europe	*North America*	*Asia*	*Total*
Number of Companies Surveyed	**44**	**54**	**30**	**128**
Planning to Invest	41	28	14	82
Currently Investing	33	18	3	54
With an East European Strategy	31	17	2	50
Percent of Those Surveyed				
Planning to Invest	93	52	47	64
Currently Investing	75	33	10	42
With an East European Strategy	71	32	7	39
Memo Items *(US$ millions)*				
Disclosed Investment	1,739	333	1,155	3,227
Annual average per country				81

Source: DRT International, *Corporate Investment Plans for Eastern Europe — A Global Survey*, September 1990.

East Germany and the USSR as well as the six countries of the region, so that what seems like a substantial amount — $3.2 billion — translates into an average of only a little over $80 million per country per year. The sample is most certainly not exhaustive, so that this number gives a low indication of likely direct investment into the Six, the Soviet Union and East Germany over the next few years.

Recent disappointments notwithstanding, direct investment into East Germany will be far higher than into the Six individually, and might exceed them in total. The reasons for this are clear: a stable currency; an international language; an established body of commercial law; and relatively clear ownership rights. Moreover, given its established trading ties into Eastern Europe, some operations in East Germany will have relatively easy access to the six countries of the region. East Germany is likely to divert some direct foreign investment — precisely how much is impossible to gauge — from the Six in the near term.

One further consideration is that many investment plans are based

Box 12. PepsiCo's Lessons

PepsiCo operates on a worldwide basis within three industrial segments — soft drinks, snack foods and restaurants — and has unique experience operating behind the Iron Curtain. PepsiCo's soft drink products have been manufactured and distributed in Eastern Europe since the middle of the 1960s and in the Soviet Union since 1974. PepsiCo's Pizza Hut subsidiary has recently negotiated a joint venture with the city of Moscow, which currently operates two Pizza Hut restaurants.

PepsiCo's experience in Eastern Europe over the past 35 years offers several lessons for would-be investors and for the countries of the region:

- *Tenacity is essential.* PepsiCo's senior management spent a significant amount of time and was intimately involved in setting up its operations in Eastern Europe. Senior management, a scarce resource at PepsiCo, continues to play an active role in supporting and expanding the company's operations in this region. For the country involved, the lesson is that bureaucratic hurdles cost more than the opportunity cost of money. For would-be investors, the lesson is that setting up a worthwhile operation can be a difficult, time- consuming process.
- *Political risk provides opportunities.* PepsiCo has established a firm foothold in the region partially because it got there first. It was willing to take risks in the early years to build a presence and, as a result, its competitors are playing catch up in most Eastern European countries. Given the major changes in the political and economic systems of the region, firms in other industries cannot expect lead times as long as PepsiCo's; however, being among the leaders in the region will clearly be of value.

on joint ventures. The announced numbers may well, therefore, include local financing by the Western partner and, in addition, the local contribution by the joint venture partner. Joint ventures have mushroomed in

- *The value of privatized assets.* PepsiCo's franchise bottlers in Eastern Europe tend to be state enterprises. Their plants are effective. However, the efficiency level is well below industrial country standards because of aging infrastructure, dated technology and inefficient labor rules. As a result, PepsiCo does not consider privatization the primary vehicle for expanding the East European market. Rather it is likely to pursue joint ventures, in both bottling and bottling-related infrastructure industries; support programs to facilitate the upgrade of existing facilities; and management training and support.
- *Big transfers of "know-how" are possible without large transfers of capital.* PepsiCo's operations have served to transfer to management and workers several all-important attitudes — customer service, quality control, the value of specific expertise, and the importance of brands (as a shorthand way for customers to recognize high quality and consistency) — even with relatively small capital outlays. Franchising may be a very useful way of nurturing an entrepreneurial culture with relatively limited capital flows.
- *The East European markets are small.* The entire region is a much smaller market for PepsiCo than is Mexico, for example, a single developing country. To be economical, the markets may have to be served by individual operations covering more than one country. The governments in the region must accept that in the future they may have to depend on neighbors for strategic as well as non-essential products. Otherwise, the gains from trade will be elusive.

Source: Discussions with PepsiCo officials.

number throughout the region, rising from 915 to almost 3,500 between August 1989 and 1990 (Table 15), a welcome development. But at the same time, it means that considerable caution is warranted in making any inference that large investment intentions translate into prospects for significant capital inflows on a balance of payments basis.

In addition to the broad sample that led to the $3.2 billion figure for direct foreign investment, there are other data on investment deals into the area. The table in Box 13 on auto-company investments that have been announced or are under consideration suggests that much larger numbers might be appropriate. If the two surveys do not overlap, investments reported in these two sources would total $10.8 billion.

One of them — the large Volkswagen investment in Skoda in the CSFR — highlights another problem with analyzing the current outlook: Given the size and number of the majority of known investments, a single, new large one can radically alter the outlook for growth of the total direct foreign investment flows into the region. Assuming the majority of other investments will be made in the next five years, the average annual auto-industry investment per country into the region is probably about $150-200 million, including the Skoda investment. Excluding it, the average is $20-30 million.

One further consideration regarding direct investment flows into the region should be taken into account: the abundance of small financing opportunities that may be available, particularly in Poland, the CSFR and Hungary. In these three countries, growing evidence seems to indicate that the newly emerging private sector is encouraging private investment from the industrial countries. But the amounts are very small — $50,000 here and $100,000 there — and it is difficult to gauge how much these might add up to. Moreover, there is the more substantive problem of intermediation.

The total volume of financing from the private sector may grow quite rapidly over the next five years. It will no doubt provide many vital inputs to the transformation process — technological transfers and access to industrial country markets, among other things. But it is unlikely to come close to meeting the balance of payments financing needs of the region.

Table 15. Western Joint Ventures
(August 1990)

	Western Partners
Bulgaria	60+
CSFR	220+
Hungary	1,100
Poland	1,200
Romania	10+
Yugoslavia	900+
Total	3,400

Source: US Department of Commerce, August 20, 1990.

The Public Sector

To finance the bulk of their foreign exchange requirements the six countries of the region will have to look to the official bilateral sources and the multilateral agencies for the next several years. Table 16 summarizes the official financing contained in the baseline scenario.

Bilateral Sources. The analysis of bilateral disbursements is based on data reported by the European Commission, which was charged at the Houston Summit with coordinating aid efforts to the region. Table 17 summarizes commitments from August 1989 through December 1990.

Disbursements by the individual EC members and other official bilateral sources are projected to rise from about $2 billion in 1991 to about $5.7 billion in 1995. At first glance, this may appear low in light of the G-24 countries' offer of new credits to Poland and Hungary. Between the end of the 1989 Paris Summit and mid-June 1990, more than $10 billion was committed. But some of these credits will take time to disburse. Others are lines of credit tied to trade, which have been accounted for in our discussion of short-term financing.

Box 13. Prospects in the Auto Industry

The allure of Eastern Europe for Western automobile companies is obvious: a potential market of many millions of cars a year, cheap skilled labor and governments anxious to attract foreign investment. Shortly after the political changes in 1989, Western auto companies began seeking — and in some instances finding — investment opportunities in the region. (See table.)

The euphoria quickly began to dim, however, as the companies began to acquire first-hand experience of the existing Eastern European business setting and found their initial expectations to be somewhat unrealistic. The problems they encountered included existing manufacturing facilities that were beyond economic redemption, unmotivated workers with unrealistic expectations, inadequate infrastructure (telecommunications, banking facilities), murky free-market reform, and uncertain economic growth prospects.

Some Western auto companies are apparently reconsidering their investment plans for the region. Others, however, have made large commitments in principle. In particular, Volkswagen has committed to investing with Skoda in a project that would double its capacity to produce cars over the next ten years, where a total investment of $6.5 billion is possible.

Source: A submission to the Study Group by General Motors, and the *Wall Street Journal,* November 14, 1990.

Multilateral Sources. Disbursements from multilateral institutions, (the World Bank, the IFC, the International Monetary Fund, the European Community, the European Investment Bank and the EBRD) are shown growing from $1.6 billion in 1990 to $4.9 billion in 1995 in the baseline scenario, a compound annual growth rate of about 25 percent.

EBRD lending could rise quickly, once established, but may be constrained by the fact that 60 percent of its lending must go to the private sector. In addition, the gestation period — the time between the conception of a project and its submission to the board for approval —

Auto Deals Announced or Under Consideration

Country	*Company*	*Joint Venture Partner*	*Amount (US$ millions)*
Bulgaria	General Motors	(Wholly-owned sales company)	0.5
CSFR	Volkswagen	Skoda (over 10 years)	3,225.0
	(undecided)	Skoda	3,200.0
	General Motors	BAZ	150.0+
	Renault	BAZ	—
Hungary	General Motors	RABA	150.0
	Suzuki	Autokonszern RT	46.0
	Ford	(Wholly-owned manufacturing)	—
	General Motors	Villszov	—
Poland	Fiat	FSM	650.0
	General Motors	(Wholly-owned sales company)	0.5
	Fiat	FSO	—
Romania	General Motors	(Wholly-owned sales company)	0.5
Yugoslavia	Volkswagen	UNIS-TAS	130.0
	Fiat	Zavodi Crvena Zastava	—
	Renault	IMV	—

will likely be 18 to 24 months, as it is in the World Bank, delaying outlays somewhat. It will also take some time for World Bank disbursements in Bulgaria and in the CSFR to build up, as these two countries first became eligible for financing in the fall of 1990.

Debt Reduction. In two countries in the region — Bulgaria and Poland — the debt burden has become so severe that, at the start of 1991, it constituted a major impediment to future growth. Some form of debt reduction seemed necessary if growth was to resume.

Table 16. Baseline Scenario for Official Financing
(US$ billions)

	1991	*1992*	*1993*	*1994*	*1995*	*1991-1995*
Bulgaria						
Total	0.8	0.7	0.7	0.8	1.0	4.1
Multilateral	0.6	0.4	0.5	0.5	0.7	2.7
Bilateral	0.2	0.2	0.3	0.3	0.3	1.3
CSFR						
Total	2.0	2.0	2.1	2.5	2.9	11.5
Multilateral	1.7	1.0	0.9	1.0	1.1	5.7
Bilateral	0.3	0.9	1.2	1.5	1.8	5.8
Hungary						
Total	3.0	1.9	2.1	2.5	3.0	12.6
Multilateral	2.6	1.3	1.4	1.6	1.9	8.8
Bilateral	0.5	0.6	0.7	0.9	1.1	3.7
Poland						
Total	2.5	1.7	1.9	2.0	2.3	10.3
Multilateral	2.0	1.2	1.3	1.4	1.6	7.5
Bilateral	0.4	0.5	0.6	0.6	0.7	2.8
Romania						
Total	1.3	1.1	1.4	1.5	1.7	7.1
Multilateral	1.2	0.7	0.7	0.7	0.7	4.0
Bilateral	0.2	0.4	0.7	0.8	1.0	3.1
Yugoslavia						
Total	1.3	1.2	1.2	1.3	1.5	6.4
Multilateral	0.8	0.7	0.6	0.7	0.8	3.5
Bilateral	0.4	0.5	0.6	0.6	0.7	2.9
Regional Total						
Total	10.9	8.4	9.4	10.6	12.5	51.8
Multilateral	8.9	5.3	5.3	5.9	6.8	32.2
Bilateral	2.0	3.1	4.1	4.8	5.7	19.6

Source: Study Group Secretariat estimates.

Table 17. G-24 Commitments in 1990
(US$ billions)

	Poland	*Hungary*	*Bulgaria*	*CSFR*
Germany	2.7	2.2		
France	1.0	0.4		
Japan	1.0	0.9		
E.C. Commission	0.8	1.7	*	*
United States	0.8	0.3		0.1
Italy	0.7	0.2	*	
Austria	0.4	0.2		
United Kingdom	0.2	*		
Denmark	0.2	0.1		
Switzerland	0.2	*		
Others	0.8	0.6		
Total	8.8	6.6	0.1	0.1

Note: * means a commitment of less than $50 million.
Source: Various official sources.

But the situation in the two countries was, and is, very different:

- Poland's debt is largely to official creditors, whereas Bulgaria's is to commercial banks.
- Poland's debt is large in absolute amounts, whereas Bulgaria's is relatively small.
- Poland has undertaken a major reform of the economy in the past twelve months, whereas Bulgaria is only now developing the sweeping proposals needed for its economic transformation.

The Polish debt situation warrants special discussion. At the end of 1990, Poland's external convertible currency debt amounted to about $46 billion. Nearly $33 billion of this amount was owed to industrial country governments (the Paris Club creditors) and about $9 billion to industrial country banks. In this respect, the division of Poland's debts between governments and banks differs from that facing most other official debtors seeking debt relief.

Between 1981 — when Poland's inability to service its debts first surfaced — and 1990, these two groups of creditors entered into numerous rescheduling agreements with the government of Poland. The Paris Club creditors rescheduled most of the principal and interest (including moratorium interest on rescheduled debt) due to them in this time frame, while the banks rescheduled 95 percent of principal only. The $20 billion increase in Poland's external debt between 1981 and the present is due to the capitalization of interest payments due the Paris Club creditors (i.e., adding unpaid interest to the existing stock of debt through the rescheduling process).

For 1991, Poland's debt service obligations before debt reduction come to about $8.3 billion. Between 1992 and 1995, annual amortization obligations alone would range between $3.5 and $4.4 billion in the absence of debt reduction efforts.

It was in consideration of Poland's unprecedented efforts at reform and stabilization that the working group of the Paris Club met early in 1991 and developed a two-stage plan for the country. This plan would cut in half Poland's existing debt obligations to the industrial country governments. The Paris Club and Poland would formalize this agreement once Poland's three-year Extended Fund Facility (EFF) with the IMF was approved, later in the year. The debt would be reduced through a menu of options, in two stages:

- During the first three years, there would be a 30 percent reduction in the net present value of debt to each creditor country, including an 80 percent reduction in interest payments.
- In the fourth year, upon successful completion of the EFF, there would be another 20 percent reduction.

The Paris Club creditor governments also agreed to set up a debt swap facility, in which participation would be voluntary, which could reduce Poland's debt to them by another 10 percent.

As Paris Club agreements are purely advisory, Poland and each of the 17 creditor governments will now have to negotiate bilateral agreements in order to implement the framework agreement. This will take some time but should be completed well before the end of 1991 for most of the creditor governments.

During Polish President Walesa's visit to the United States in March

1991, President Bush announced that the United States would go beyond the Paris Club agreement and would write off an additional 20 percent of Poland's debt. The overall 70 percent reduction in US official debt would then, in due course, be worth nearly $2.7 billion to Poland. Subsequently, on the eve of President Walesa's visit to France this year, the French government forgave another $50 million of Polish debt, raising its total above 50 percent.

Poland's outstanding debt to commercial banks raises difficult issues. The banks are under some pressure to accept a cut in their claims. If they accede, Poland's debt burden will fall, but its ability to raise commercial funds in the future may be impaired. The net value to Poland depends critically on any future settlement being reached in a fully cooperative manner.

In the quantitative analysis, it is assumed that debt relief for Poland would equal about 55 percent of official amortization and interest over the forecast period. This assumes that, in rough terms, the eventual bilateral agreements negotiated with Poland would conform to the working group framework agreement. It does not assume, however, that the commercial bank creditors would reach an agreement with Poland to ameliorate substantially the burden of past commercial debts. If this were to happen, it would further reduce Poland's overall financing needs and could improve its prospects for growth.

In Bulgaria's case, the baseline scenario forecasts on the external account were impossible to make without an assumption about future commercial bank debt. In theory, there are three alternatives:

- Massive new borrowing to service past debt;
- Unilateral indefinite accrual of arrears; or
- Substantial debt reduction as a result of negotiations between the London Club creditor banks and the Bulgarian government.

On analysis, the first of these did not seem feasible. The effect of the second or third alternative on the total external financing requirements of the balance of payments could be much the same, but their effect on the availability of finance would be greatly different. Clearly, what is of prime importance for Bulgaria — as for Poland — is that, the final resolution of its external debt problem be achieved in a cooperative spirit among the parties involved.

For the specific purposes of building up the scenario, therefore, it was assumed that 100 percent of medium- and long-term debt amortization would be offset by debt reduction measures of one means or another, together with 85 percent of interest payments due. Obviously, an acceptable final agreement might settle on a different mixture of amortization and interest offset, postponement or reduction, and the overall level of relief might be more or less, but the scenario does serve to illustrate that, even with such sweeping measures, Bulgaria's growth prospects are not especially strong — reaching only 3 percent in 1995, when, in the baseline scenario, economic activity is still a full quarter below the level of 1989.

Debt Prospects

This overall outlook for future financing by both official and private sources carries with it implications for the accumulation of debt in the baseline scenario. The prospects for the net investment position in the region are summarized in Table 18. Equivalent tables for each country in the region appear in Annex 1. Debt, here, is before debt reduction or offsets. If these are taken into account, debt service ratios would be cut by about one-third for Poland and by about nine-tenths for Bulgaria. Outstanding equity, as it is shown in the table, is the cumulative total of equity financing flows from 1991 onward. It is an estimate of the net stock of foreign equity in the region for which there are no good independent statistics.

Table 18 and the associated Annex tables serve to make one important point: namely, that debt service in this scenario does not grow in relation to trade, except in the CSFR and Romania, where current debt levels are modest. In other words, debt remains at manageable levels. Indeed, one of the few immediate benefits from the change in the CMEA from transferable-rouble to convertible-currency settlement for the six countries of the region is that their debt service ratios — where exports are the denominator — improve between 1990 and 1991.

Table 18. Baseline Scenario for the Region's Net Investment Position
(US$ billions)

	1991	*1992*	*1993*	*1994*	*1995*
Outstanding Debt	**119.3**	**124.6**	**127.0**	**129.9**	**132.6**
Long-Term	100.9	101.6	102.0	102.8	103.4
Official	65.6	67.5	69.2	71.1	72.7
Multilateral	18.7	21.2	23.3	25.2	27.1
Bilateral	47.0	46.3	45.9	45.8	45.6
Private	35.3	34.1	32.9	31.7	30.7
Short-Term	18.4	23.0	24.9	27.1	29.2
Outstanding Equity (1991 onward)	**0.9**	**2.5**	**4.4**	**6.6**	**9.0**
Debt Service	**21.1**	**24.0**	**25.3**	**26.6**	**29.5**

Source: Study Group Secretariat estimates.

The Overall Outlook in the Baseline Scenario

Financing uses in the baseline scenario for the region are summarized in Table 19. Hard-currency financing needs — the current-account balance and amortization due — grow from $38 billion in 1991 to $57 billion by 1995.

The external financial needs for the region as a whole are indeed quite large during that period. They arise largely out of the changes in the CMEA trading rules, Poland's continuing debt service obligations — even after debt relief — and, of course, the impact of the domestic transformation on the external account.

The baseline scenario of likely sources and uses of financing indicates how they might be balanced. This is summarized in Table 20, which shows annual figures and a cumulative total for 1991 to 1995. Certain aspects of the scenario stand out:

- Trade is almost balanced. The difference between the import and export figures is very small compared with total sources or uses

Table 19. Baseline Scenario for Financing Uses

(US$ billions)

	1991	*1992*	*1993*	*1994*	*1995*
Bulgaria					
Current Account Balance	-2.2	-1.8	-1.9	-1.6	-1.6
Trade Balance	-1.1	-0.8	-1.0	-0.9	-0.9
Interest Payments	-1.2	-1.1	-1.0	-0.9	-0.8
Net Transfers	0.1	0.1	0.1	0.1	0.1
Amortization Payments	-2.9	-2.6	-2.8	-3.1	-3.1
Long-Term	-1.6	-1.2	-1.3	-1.4	-1.6
Short-Term	-1.2	-1.3	-1.5	-1.7	-1.6
Accumulation of Reserves	0.0	-0.1	-0.1	-0.1	-0.3
Total Uses of Funds	-5.0	-4.4	-4.8	-4.9	-5.0
Hungary					
Current Account Balance	-1.2	-1.0	-0.5	-0.5	0.5
Trade Balance	0.5	0.9	1.2	1.1	2.1
Interest Payments	2.2	-2.4	-2.3	-2.2	-2.2
Net Transfers	0.5	0.6	0.6	0.6	0.6
Amortization Payments	-5.8	-6.9	-7.9	-8.8	-9.7
Long-Term	-2.2	-3.0	-3.3	-4.0	-4.8
Short-Term	-3.6	-4.0	-4.6	-4.8	-4.9
Accumulation of Reserves	-1.0	-0.1	-0.3	-0.4	-2.4
Total Uses of Funds	-8.0	-8.0	-8.8	-9.6	-11.4
Poland					
Current Account Balance	-2.8	-3.4	-3.9	-3.4	-2.9
Trade Balance	0.5	0.7	-0.3	-0.3	0.0
Interest Payments	-4.9	-5.7	-5.4	-5.0	-4.8
Net Transfers	1.6	1.7	1.8	1.8	1.9
Amortization Payments	-5.6	-6.5	-6.6	-7.3	-8.5
Long-Term	-3.5	-3.5	-3.5	-3.7	-4.4
Short-Term	-2.2	-3.0	-3.1	-3.6	-4.1
Accumulation of Reserves	-0.1	-0.3	-0.5	-0.4	-0.4
Total Uses of Funds	-8.5	-10.2	-11.0	-11.1	-11.8
Yugoslavia					
Current Account Balance	-1.1	-1.2	-0.2	-0.3	-0.4
Trade Balance	-0.2	-0.3	0.9	0.5	0.4
Interest Payments	-2.2	-2.3	-2.5	-2.3	-2.4
Net Transfers	1.3	1.4	1.4	1.5	1.6
Amortization Payments	-6.9	-7.4	-9.0	-9.5	-10.5
Long-Term	-1.8	-1.8	-2.1	-2.2	-2.4
Short-Term	-5.1	-5.6	-7.0	-7.3	-8.2
Accumulation of Reserves	0.5	-0.4	-0.3	-0.7	-0.7
Total Uses of Funds	-7.6	-9.0	-9.4	-10.5	-11.7

Table 19. Baseline Scenario for Financing Uses *(continued)*
(US$ billions)

	1991	*1992*	*1993*	*1994*	*1995*
CSFR					
Current Account Balance	-2.5	-2.6	-2.0	-2.2	-2.0
Trade Balance	-1.7	-1.4	-0.6	-0.7	-0.3
Interest Payments	-0.8	-1.2	-1.4	-1.6	-1.8
Net Transfers	0.0	0.0	0.0	0.1	0.1
Amortization Payments	-2.6	-5.2	-6.8	-7.9	-9.0
Long-Term	-0.7	-1.1	-1.5	-2.0	-2.6
Short-Term	-1.9	-4.1	-5.3	-6.0	-6.4
Accumulation of Reserves	-1.5	-0.7	-0.8	-0.5	-0.4
Total Uses of Funds	-6.6	-8.4	-9.6	-10.7	-11.5
Romania					
Current Account Balance	-1.9	-1.9	-1.1	-1.6	-1.2
Trade Balance	-1.9	-1.7	-0.8	-1.1	-0.6
Interest Payments	-0.1	-0.3	-0.5	-0.6	-0.7
Net Transfers	0.1	0.1	0.1	0.1	0.1
Amortization Payments	-0.3	-1.5	-2.7	-3.0	-3.8
Long-Term	-0.1	-0.3	-0.5	-0.7	-1.0
Short-Term	-0.3	-1.2	-2.2	-2.3	-2.7
Accumulation of Reserves	-0.4	-0.1	-0.1	-0.2	-0.2
Total Uses of Funds	-2.5	-3.4	-3.9	-4.7	-5.1
Regional Totals					
Current Account Balance	-11.6	-11.7	-9.6	-9.6	-7.6
Trade Balance	-3.8	-2.6	-0.5	-1.3	0.7
Interest Payments	-11.3	-12.9	-13.1	-12.6	-12.7
Net Transfers	3.6	3.8	4.0	4.2	4.4
Amortization Payments	-24.2	-30.1	-35.9	-39.7	-44.6
Long-Term	-9.9	-11.0	-12.2	-14.0	-16.8
Short-Term	-14.3	-19.1	-23.7	-25.7	-27.9
Accumulation of Reserves	-2.5	-1.7	-2.0	-2.3	-4.3
Total Uses of Funds	-38.3	-43.5	-47.5	-51.5	-56.5

Source: Study Group Secretariat estimates.

of funds.

- The current account deficit for the region is more than accounted for by future interest payments.
- Together with amortization payments, these explain almost all of the use of funds. This is true whether or not short-term sources and uses are included in the analysis — as they are in Table 20.

(The main effect of removing them from the analysis is to remove the $126 billion from the sources of financing and a similar amount from the amortization of uses of funds.)

- The long-term sources of funds are dominated by official debt financing.
- Assumed debt relief is important, but it is by no means the most important source of funds in the scenario.
- Net financial flows to the region — which are defined as the sources of funds minus amortization payments — are about one-quarter of the total sources of funds for the region. This would rise to about one-half, if short-term financing were excluded.
- Net real transfers — which are net financial flows minus interest payments — are very small indeed in relation to the overall financial flows to the region. In this respect, the baseline scenario suggests that Eastern Europe may resemble other groups of debtor countries.

The Sensitivity of the Baseline

How big was the impact of the changes in the CMEA trade regime introduced this year? How much does any scenario depend on the specific assumptions about GNP rates or oil prices? The sensitivity analysis on Poland's external accounts, presented in Table 21 in terms of dollars and as a percentage of the current account deficit forecast in the main scenario, addresses both questions to some degree.

Line 1 shows the part of Poland's current account deficit attributable to the change in the terms of trade in the CMEA region, mostly the result of higher fuel costs. Poland is a net fuel importer.

Line 2 shows the effect of valuing trade at a realistic exchange rate of one transferable rouble for every 50 cents, or so in place of the official rate of one rouble for every $1.59. It greatly reduces the value of Poland's bilateral surplus with the Soviet Union — a much larger impact than the terms-of-trade change, reflecting the distortions that went with the transferable rouble as a unit of account.

Line 3 shows the positive effect of the world oil price's being lower

Table 20. Baseline Scenario for Regional Financial Flows
(US$ billions)

	1991	*1992*	*1993*	*1994*	*1995*	*1991-1995*
Uses of Funds	**-38.3**	**-43.5**	**-47.5**	**-51.5**	**-56.5**	**-237.4**
Current Account Balance	-11.6	-11.7	-9.6	-9.6	-7.6	-50.0
Trade Balance	-3.8	-2.6	-0.5	-1.3	0.7	-7.5
Interest Payments	-11.3	-12.9	-13.1	-12.6	-12.7	-62.6
Net Transfers	3.6	3.8	4.0	4.2	4.4	20.1
Amortization Payments	-24.2	-30.2	-35.9	-39.6	-44.6	-174.5
Accumulation of Reserves	-2.5	-1.7	-2.0	-2.3	-4.3	-12.9
Sources of Funds	**38.3**	**43.5**	**47.6**	**51.6**	**56.5**	**237.5**
Debt Financing	31.7	34.7	38.3	42.6	47.3	194.6
Long-Term	12.6	11.0	12.6	14.7	17.4	68.3
Official	10.9	8.4	9.4	10.6	12.5	51.8
Multilateral	8.9	5.4	5.3	5.9	6.8	32.3
Bilateral	2.0	3.1	4.1	4.8	5.7	19.6
Private	1.7	2.5	3.2	4.1	4.9	16.4
Short-Term	19.1	23.7	25.7	27.9	29.9	126.3
Equity Financing	0.9	1.6	1.9	2.2	2.4	9.0
Assumed Debt Relief	5.7	7.3	7.4	6.8	6.7	33.9
Memo Items						
Net Financial Flows	14.1	13.3	11.7	11.9	11.9	63.0
Net Real Transfers	2.8	0.4	-1.4	-0.6	-0.8	0.4

Source: Study Group Secretariat estimates.

than assumed in the baseline scenario: around $15 in nominal terms per barrel in 1991 and throughout the forecast period, as opposed to around $20 a barrel.

Line 4 shows the effect of 1 percent higher Soviet growth throughout the forecast period. Soviet-Polish trade is not expected to grow in relation to Soviet GNP for a while. By contrast, the effect of a 1 percent higher growth rate in the industrial countries (line 5) is much larger because Poland's share of trade in the west is likely to rise and trade

Table 21. The Sensitivity of the Baseline Scenario: The Example of Poland

	1991	*1992*	*1993*	*1994*	*1995*
Absolute Values *(US$ billions)*					
CMEA Changes					
1. Terms-of-Trade Change	0.3	0.3	0.3	0.3	0.3
2. Adopting a Realistic Exchange Rate	2.3	2.4	2.1	2.3	2.5
3. An Oil Price Decrease to $15.00	-0.4	-0.7	-0.7	-0.5	-0.3
4. 1% Faster Soviet Growth	0.0	-0.1	-0.1	-0.1	-0.2
5. 1% Faster Industrial Country Growth	0.0	-0.3	-0.7	-1.1	-1.6
6. 1% Faster Polish Growth	0.2	0.4	0.7	1.0	1.3
Memo Item					
The Forecast Current Account Deficit	2.8	3.4	3.9	3.4	2.9
As a Percentage of the Current Account Deficit					
CMEA Changes					
1. Terms-of-Trade Change	10.0	7.6	6.5	8.1	10.4
2. Adopting a Realistic Exchange Rate	84.7	70.4	52.7	67.5	86.6
3. An Oil Price Decrease To $15.00	-16.0	-21.2	-17.1	-14.3	-12.0
4. 1% Faster Soviet Growth	-1.3	-1.9	-2.5	-4.1	-6.5
5. 1% Faster Industrial Country Growth	0.0	-9.7	-17.3	-32.4	-56.5
6. 1% Faster Polish Growth	6.9	12.4	17.4	28.6	44.8

Source: Study Group Secretariate estimates.

volumes in general are likely to continue increasing in relation to industrial country GNP.

Line 6 shows that the higher imports associated with a 1 percent higher rate of Polish domestic economic growth would expand the current account deficit. It is of the same order of magnitude as the positive effect of industrial country growth, underlining directly how important healthy economic prospects for the OECD are for the Polish economy. Indirectly, it also serves to reinforce how important good access to industrial country markets will be.

Accelerating The Transformation: A Second Scenario

One of the specific assumptions of the baseline scenario is that reform will continue more or less on course, as outlined in Chapter 2. Unfortunately, that scenario suggests that real economic growth will resume only after a rather lengthy period of contraction.

Because such protracted economic hardship might undermine public acceptance of the costs of reform, this section examines a second alternative scenario, which shows how the resumption of growth might be hastened. This accelerated growth scenario depends on accelerating domestic reforms, which should increase economic efficiency earlier on in most of the economies of the region. It should lead to more efficient domestic resource mobilization and allocation and an earlier abandonment of uneconomic plants, firms and economic activities in general.

Moreover, accelerated reform should increase absorptive capacity for external financing and, while it would increase financing needs, should also attract more official support from abroad in the near term and private sector financial inflows toward the end of the forecast period. Because of these associated effects, the gains in terms of faster growth and increased foreign financing that accompany accelerated reform may be quite substantial.

First, however, it is reasonable to expect that the dislocations associated with the earlier stages of reform would be magnified. The decline in real GNP in 1991 would be larger as, for example, governments moved more quickly to close inefficient enterprises. Unemployment would rise and the evolving social safety nets would be tested. More businesses would fail in the short run, as swifter reductions in trade barriers exposed them to extra international competition.

The second scenario does not, therefore, begin with accelerated growth. In 1991 and 1992, GNP is assumed to be 2 percent and then 1 percent lower than in the base scenario in every country in the region. The decline in imports that might have resulted, is offset by faster liberalization of imports — lower tariffs and reduced non-tariff barriers to trade — so that the overall financing needs of each country are unchanged for these two years.

However, faster reform then sets the stage for a substantially faster recovery and more rapid economic growth after 1992. GNP rebounds in 1993 in most countries (Table 22).

There are several reasons for this. First, assuming that faster reform is comprehensive, many of the fundamental uncertainties about economic policy are quickly settled, improving the investment environment. Second, more realistic prices translate into better investment decisions — better use of resources — at an earlier date. Third, deadweight economic activity stops sooner than it otherwise would: That is, jobs and firms with negative value added at world market prices cease and the people and resources employed are released for more productive activities.

Two further reasons to be optimistic about the effect of compressing reform activities into a short period of time are that sequencing becomes moot and political momentum is maintained. The sequencing point is simply that, if by some chance policy reforms are introduced in an order that exacerbates market distortions for a time, that time will be shorter and, preferably, less damage will be incurred. The point about political momentum is that often, though not always, a faster pace of reforms can be maintained through to its conclusion more easily than a leisurely one. There is less time for opposing vested interests to coalesce.

Finally, it is probably true that a faster reform program, which loses nothing in thoroughness, will attract a larger flow of foreign financing. That, in turn, should facilitate growth after 1992. In the first instance, almost all of this is in the form of additional disbursements from bilateral and multilateral official agencies. This accelerated reform scenario indicates these disbursements as rising above what they were in the baseline by 5 percent in 1992 and 15 percent in 1993 and 1994. These increases would be possible only if there were an earlier comparable increase in commitments. The accelerated reform scenario is implicitly based on the assumption that, in general, the official agencies respond quickly and supportively to accelerated reform (Tables 23 and 24). That in turn is based on an assumption that the accelerated reform scenario is

Table 22. Accelerated Reform Scenario for Growth Prospects
(Real GNP growth in percent per annum)

	1991	*1992*	*1993*	*1994*	*1995*
Bulgaria					
Baseline Scenario	-14.0	-6.7	0.6	0.8	3.0
Accelerated Growth	-16.0	-7.7	4.0	2.3	4.3
CSFR					
Baseline Scenario	-5.7	-4.8	-3.9	4.3	4.1
Accelerated Growth	-7.7	-5.8	2.1	6.9	6.7
Hungary					
Baseline Scenario	-3.1	-0.4	1.5	2.7	3.0
Accelerated Growth	-5.1	-1.4	6.1	7.4	7.4
Poland					
Baseline Scenario	-0.2	1.6	2.6	1.8	3.2
Accelerated Growth	-2.2	0.6	5.8	5.1	5.6
Romania					
Baseline Scenario	-6.6	-5.1	-3.9	2.6	4.2
Accelerated Growth	-8.6	-6.1	0.7	4.3	5.7
Yugoslavia					
Baseline Scenario	-4.9	-2.6	-1.0	-0.5	0.8
Accelerated Growth	-6.9	-3.6	3.7	0.3	1.9

Source: Study Group Secretariat estimates.

adopted very shortly by the governments of the region.

In 1995, official disbursements in the accelerated reform scenario revert to the level only 5 percent above the baseline, although they continue to rise in absolute terms. The reasoning behind this assumption is that, in 1994 and 1995, private financial flows would begin to accelerate and take on more importance relative to official financing.

It is assumed that there is no material difference in the profile of debt relief in Poland between the baseline and the accelerated growth sce-

Table 23. Accelerated Reform Scenarios for Long-Term Financing Propects
(US$ billions)

	1991	*1992*	*1993*	*1994*	*1995*	*Distribution in 1995 of Medium- and Long-Term Financing (Percent)*
Baseline Scenario						
Long-Term Debt Financing	12.6	11.0	12.6	14.7	17.4	87.8
Multilateral	8.9	5.4	5.3	5.9	6.8	34.1
Bilateral	2.0	3.1	4.1	4.8	5.7	28.9
Private	1.7	2.5	3.2	4.1	4.9	24.7
Equity Financing	0.9	1.6	1.9	2.2	2.4	12.2
Total	13.5	12.5	14.5	16.9	19.8	100.0
Accelerated Reform Scenario						
Long-Term Debt Financing	12.6	11.3	13.8	17.1	20.7	75.4
Multilateral	8.9	5.5	5.9	6.5	7.1	26.0
Bilateral	2.0	3.2	4.7	5.5	5.9	21.5
Private	1.7	2.5	3.2	5.1	7.6	27.9
Equity Financing	0.9	1.6	1.9	3.9	6.8	24.6
Total	13.5	12.9	15.7	21.1	27.4	100.0
Incremental Financing						
Long-Term Debt Financing	0.0	0.3	1.2	2.4	3.3	43.2
Multilateral	0.0	0.2	0.5	0.7	0.4	4.7
Bilateral	0.0	0.2	0.6	0.7	0.2	2.4
Private	0.0	0.0	0.0	1.0	2.8	36.1
Equity Financing	0.0	0.0	0.0	1.7	4.3	56.8
Total	0.0	0.3	1.2	4.1	7.6	100.0

Source: Study Group Secretariat estimates.

narios. The same is the case for Bulgaria. It seems reasonable, because it is difficult to say quite what the net impact of faster reform would be on this aspect of financing flows. On the one hand, additional — or at least continued — official creditor agency debt reduction is likely to accompany accelerated reform. On the other hand, the market discount on private sector debt outstanding is likely to fall, if reform progresses better than expected; and, indeed, it must be very small before signifi-

Table 24. Accelerated Reform Scenario for Regional Financial Flows
(US$ billions)

	1991	*1992*	*1993*	*1994*	*1995*	*1991-1995*
Uses of Funds	**-38.2**	**-43.5**	**-49.0**	**-56.3**	**-65.0**	**-252.0**
Current Account Balance	-10.0	-9.3	-10.7	-13.5	-14.4	-57.9
Trade Balance	-2.3	-0.2	-1.6	-5.0	-5.7	-14.8
Interest Payments	-11.3	-12.9	-13.1	-12.7	-13.1	-63.1
Net Transfers	3.6	3.8	4.0	4.2	4.4	20.1
Amortization Payments	-25.9	-32.8	-35.5	-39.9	-45.5	-179.6
Change In Reserves	-2.3	-1.5	-2.8	-2.9	-5.1	-14.5
Sources of Funds	**38.1**	**43.5**	**49.0**	**56.3**	**65.0**	**251.9**
Debt Financing	31.5	34.7	39.7	45.5	51.5	202.9
Long-Term	12.6	11.3	13.8	17.1	20.7	75.5
Official	10.9	8.8	10.6	12.1	13.0	55.3
Multilateral	8.9	5.5	5.9	6.5	7.1	34.0
Bilateral	2.0	3.2	4.7	5.5	5.9	21.3
Private	1.7	2.5	3.2	5.1	7.6	20.2
Short-Term	18.9	23.4	25.9	28.4	30.8	127.4
Equity Financing	0.9	1.6	1.9	3.9	6.8	15.0
Assumed Debt Relief	5.7	7.3	7.4	6.8	6.8	34.0
Memo Items						
Net Financial Flows	12.2	10.7	13.4	16.3	19.6	72.3
Net Real Transfers	0.9	-2.2	0.3	3.6	6.4	9.1

Source: Study Group Secretariat estimates.

cant new private sector inflows can be expected.

Perhaps the most striking difference between the baseline and accelerated reform scenarios for regional financial flows (Tables 20 and 24) is how much larger net real transfers are in the accelerated reform scenario — $9 billion with accelerated reform, compared to $0.4 billion without, for the whole five-year period. Two-thirds of the difference, or $6 billion, is accounted for by the rise in equity financing between the two scenarios: It is $9 billion in the baseline scenario and $15 billion in the accelerated reform scenario. This serves to underline the benefit of accelerated reform in attracting additional financial flows and, at the same time, to underline the pivotal role that will develop for equity inflows in due course.

Generally, the assumptions are that medium- and long-term lending by commercial banks — guaranteed and unguaranteed — increases by 25 percent over what it was in the baseline scenario in 1994 and by 50 percent in 1995. Equity inflows — of portfolio and direct foreign investment — are generally 50 percent higher than in the baseline in 1994 and 100 percent higher in 1995. In Poland, the assumption is that foreign equity investment increases somewhat more — by $750 million in 1994 and twice that much in 1995 — over the baseline.

Although these may seem like rather big increases, it seems reasonable to assume that private capital financing would rise quite sharply for a while, once a sound policy environment was well established. In the accelerated reform scenario, financing flows from private commercial sources reach only 52 percent, or just over half, of total medium- and long-term financial inflows in 1995. (This compares with just over one-third in the baseline scenario.)

With luck, this ratio of private sector financing would rise further before the end of the century. By then, these economies should be wealthy — compared to other aid recipients — and their special claim on scarce official resources would likely diminish. If all goes well, the growth in official financing may well taper off and, in some countries in the region, may begin to decline in absolute terms. At that time, it is most desirable that the countries should have established themselves in the international capital markets and as destinations for inward direct foreign investment, inasmuch as future balance of payments financing and foreign investment inflows will increasingly have to come from private sources. Indeed, while net financial flows should continue into the region for some time, full integration into the international financial system would imply capital outflows from, as well as inflows to, the region preferably before the turn of the century.

Does the accelerated growth scenario imply any great increase in debt service burdens? Not if borrowed resources are used in productive ways that stimulate growth overall and exports in particular. Is this forecast of incremental private financing growth too optimistic? Not necessarily. If confidence develops in the direction of reform, then the prospects for private financing inflows could improve greatly.

4. Summary and Conclusions

In many respects, developments in the past two years in Eastern Europe have surpassed all expectations. When the Soviet Union allowed populist dissent in Poland and East Germany to escalate and eventually topple the established regimes, quick and decisive steps toward democracy were taken in much of the region. Certainly, political conditions changed in all six countries addressed by this report: Bulgaria, the Czech and Slovak Republic (CSFR), Hungary, Poland, Romania and Yugoslavia. In the process, most of these countries have laid the groundwork for a historic transformation from centrally planned to market-based economies.

There have been major differences, however, in the rates of economic transformation. Poland has made the greatest strides, adopting a broad program of micro- and macro-economic reform in a short period, and the results of the November 1990 Polish presidential elections suggest that the momentum will be sustained. Substantial, if more gradual, progress has occurred in Hungary, which has been evolving toward a market economy for many years. Significant economic reforms have also been enacted in Yugoslavia. After a late start, the CSFR has begun its own strong program. But Bulgaria and Romania have only just adopted macro-economic adjustment programs, and much remains to be done to flesh out their structural reform programs and start their implementation.

The first stage of economic reform — that of rejecting the centrally planned economic order and committing to a market-based approach to economic governance — is virtually complete. Legislation has been proposed or enacted, and some key institutional changes have been made. Now comes the second stage — that of testing the strength of the political commitment — as the new policies evolve and are implemented.

This report is principally concerned with the outlook for meeting the external financing needs of the six countries in the next few years. But because the availability and usefulness of external finance are inextricably linked to the rate at which these countries restructure their old institutional arrangements and build up the necessary new ones, the report also discusses the progress of, and prospects for, domestic reform.

Domestic Stabilization and Adjustment

The national governments of the region control nearly all the critical economic policy issues, which center on the question of how to combine effective stabilization with wide-ranging structural adjustment. All the governments now recognize the need for appropriate fiscal and monetary policies to stabilize their economies while systemic reforms are developed and implemented. Poland's hyperinflation has been brought under control; Hungary's large current account deficit has been reversed and its budgetary deficit eliminated. (Unfortunately, Yugoslavia's inflation has recently accelerated.) Working at different speeds, all the countries are developing the necessary legal and business frameworks that establish and protect private property rights. All six have started, or are committed to beginning, the major task of adopting the accounting standards and other business practices of the industrial countries. In time, these measures will improve the quality of the economic information available to businesses and households and will greatly enhance the efficiency of economic decision-making.

Each of the governments has taken the initial steps toward creating a modern banking system, separating the functions of the central bank and the commercial banks. The objective is clear: to establish a system that can mobilize domestic savings, provide credit on market terms and serve as an effective payments system. The governments of the region have also begun developing domestic capital markets. Privatization programs have been laid out and, in Poland, the CSFR and Hungary, begun, and the deregulation of prices and interest rates is underway. To protect the newly unemployed, safety nets are being set up or reinforced. International trade is being liberalized and currency convertibility expanded.

Yet much more needs to be done to accomplish such sweeping economic reorganization.

Rapid Implementation

The interconnected nature of these reforms highlights the need to complete their introduction quickly. To implement them simultaneously and comprehensively has proved impossible, even in those countries that have chosen to move rapidly. But policy sequencing is potentially so problematic that it might be wise to press ahead as quickly as possible on several fronts. Consider, for example, the linkage between financial sector reform, monetary and credit policy, deregulation and privatization.

- Without financial sector reforms, controlling the expansion of domestic credit and restraining the inflationary pressures associated with price deregulation is difficult.
- Without price and trade liberalization, judging the value of assets for privatization is hard, and without a reformed financial sector, the channels for mobilizing private sector savings to purchase state-owned enterprises are restricted.
- And yet, without privatization, financial sector reform can proceed only so far.

Although these interlocking conditions are complex and difficult to address, they should not be used as excuses for slowing the process of the economic transformation.

Fundamental Shifts

Successful transformation will require fundamental changes in the knowledge, capabilities and attitudes of both public officials and private citizens. For the governments in the region, liberalization and reform mean giving up control. Government officials must shift from prescribing the few permitted economic activities to proscribing the few impermissible activities, leaving households and businesses free to innovate, cooperate and compete without direct supervision. New businesses must be allowed to develop, and — difficult as it may be — old businesses must be allowed to fail. In particular, firms currently in the public sector should be allowed to go out of business if they are not economically viable.

Because economic governance becomes more subtle as it becomes more indirect, the quality of the civil service performing the economic functions of the government should be improved, even as staff numbers are cut back — an extremely difficult public administration challenge.

At the same time, workers — as well as owners and managers — in the private sector must be prepared to take the initiative, rather than wait for instructions, and to act for the good of their enterprises when opportunities present themselves. These individuals must engage in the endless quest to find and to please customers, a process central to private enterprise. The rewards of this process — profit, wealth and above average income — must be tolerated, if not actively promoted. *Profit* and *speculation* should not be seen as pejorative terms, and income inequality must be recognized as a necessary ingredient of a market economy.

Beyond accepting such attitudinal changes, governments cannot — and should not — do much to accelerate them. In many respects, communism's failure stems from unsuccessful governmental attempts to engineer changes in individual beliefs. To repeat the mistakes of the past in the name of capitalism would be disastrous.

Realistic Expectations

There is a need to guard against unrealistic expectations of immediate improvements in economic welfare. It is very difficult to conceive of Eastern European living standards' rising to levels equivalent to those of the industrial countries in the next five or even ten years, although before the middle of the decade the growth rates in some of the region may well exceed those averaged by industrial countries. Together with the income redistribution that will necessarily accompany structural adjustment, slow growth may prevent many people in the region from reaping their desired benefits for some time to come.

Specific Adjustments

In addition to these general nostrums, many specific steps need to be implemented, if reform is to advance to the point where inflows of private capital significantly increase. Among the steps discussed in the main body of the report, the following should be highlighted:

- The first priorities in the financial sector are the deregulation of interest rates and the abandonment of credit allocation by the state. The newly created commercial banks must become independent organizations with strong balance sheets and the capability to act as effective conduits of savings toward investment, as suppliers of credit at market prices to creditworthy borrowers, and as efficient components of the payments system. Emphasis must be placed on training bank officers in credit assessment, project appraisal and lending procedures. Other financial intermediaries are needed, too, but at this stage the development of a sound and reliable commercial banking system takes precedence. Providing foreign banks with ready access to Eastern European domestic markets would help achieve such a system. Twinning arrangements, such as those developed by the International Finance Corporation (IFC) between Polish banks and foreign private commercial banks, would also be desirable. A concerted effort is needed to train bank personnel to analyze project loans, assess the credit of borrowers and perform such tasks as routine financial analysis. Continued bilateral and multilateral technical assistance for the central banks of the region, to help in the design and implementation of supervisory systems, is desirable. At the same time, the development of domestic capital markets for both bonds and equities should be encouraged. Although these markets need not be large or technologically sophisticated, the concept of dealing with and in capital markets should be nurtured.

- Privatization needs to continue apace. Aside from the obvious opportunity that the sale of state assets provides for inflows of foreign capital, the change from public to private ownership does much to ensure that the domestic business environment will be hospitable to foreign capital. A successful privatization program achieves two things: the establishment of profitable, independent businesses; and the closure of businesses that are not viable. Although the objectives of maximizing revenues for the public purse and widely distributing ownership may be politically important, developing viable enterprises is the most important economic result of the rationalization of industry ownership, management and structure.
- The formation and development of private businesses must also be encouraged outside the privatization process. Where licenses are needed, they should be issued expeditiously. Public policy must foster nascent private businesses by being evenhanded about allocating access to public goods and services, and every effort must be made to ensure that the policies are fairly implemented.
- So far as trade and currency liberalization are concerned, progress toward openness must continue. The clear objectives are full convertibility; a single exchange rate; uniform and relatively low tariff rates; and unrestricted flows of goods, services and currencies. Establishing stable and open price regimes, a competitive exchange rate and open capital markets are the prerequisites for full integration into the international economic system.
- Faced with short-term disruptions in trade, the region's governments should consider the proposal to develop a reinsurance mechanism for local export credit guarantee agencies with the backing of industrial countries. This might be arranged through one of the multilateral agencies as an initiative that all the countries of the region could back jointly, to help finance trade among themselves until their own export credit guarantee agencies be-

came established in the international capital markets.

- The impetus to improve the quality of the economic information available to the private sector needs to be reinforced. Not only must industrial country standards of accounting and disclosure be phased in as quickly as possible, but a great deal of technical assistance at a practical level is needed to educate managers, investors and civil servants about the nuances of accounting methodologies and meanings.

Despite the inevitable setbacks along the way, the direction and momentum of reform must be sustained from initial political commitment, through legislation, to policy implementation. Continued official financing will be contingent upon continued progress. Private financing will become significant only when basic reforms have become irreversible and there is a solid political consensus that the direction of the reform should be maintained.

Before considering the study's conclusions regarding the character and extent of external financing needs, one further point should be made concerning the industrial countries' policies toward the region. Difficult as it may be to increase the access of Eastern European enterprises to the industrial countries' agricultural, industrial and consumer markets, the industrial countries must make major efforts on this front. There is little point in advocating market-based economic systems and then withholding the key form of assistance needed to achieve the transformation. At the global level, the success of the current Uruguay Round of multilateral negotiations will be crucial. At the regional level, the burden of increasing openness will fall heavily on the European Community.

Financing the Transformation

If the far-ranging program of reform is to continue, and if the economies of the region are to move onto sustainable growth paths as quickly as possible, substantial financial inflows will be needed.

Conditions in Eastern Europe have changed so dramatically and continue to change so rapidly that projections of financial needs and sources are, at best, merely illustrative of what *might* happen. As a result of the recession in the OECD economies and the strains created by the reunification of Germany, conditions in the industrial countries also have changed. Nevertheless, the Study Group takes the view that it is useful to try to quantify the external funding problems confronting the countries in the region.

Four factors contribute to the financing needs of the region. First, Poland requires financing to service past debts, despite recent debt relief from official creditors. Although in the next two or three years the country will probably run a surplus on its external transactions before debt servicing, substantial financing will be needed for its remaining debt servicing obligations.

Second, for each of the countries in the region, the balance of payments is deteriorating sharply, as a result of changes in the terms of trade with the Soviet Union. Under the old transferable rouble arrangements within the Council of Mutual Economic Assistance (CMEA), the price of oil, valued at a realistic exchange rate, was about $7 per barrel. Under the new arrangements, which began taking effect in January 1991, the average price is rising to world market prices and must be paid in convertible currency. Moreover, the unit price of Eastern European exports to the Soviet Union is expected to drop as they begin to compete directly with goods from the industrial countries.

Third, the process of transformation itself requires resources. Whatever their capacity to mobilize resources domestically, these economies may well need external financing to fund imports. If import liberalization proceeds apace — which would help ensure that the budding private sector is, in fact, efficient — import growth will likely outrun Gross National Product (GNP) growth by a wide margin, even if imports of consumer goods are discouraged.

Finally, the fragility of the industrial countries' near-term economic outlook and, more dramatically, the Soviet economy's collapse mean that export opportunities will be fewer than they otherwise would have been. The volume and value of exports no doubt will eventually increase but not as quickly as they might have.

Possible Scenarios

The implications of these and other factors that will influence future external financing are explored in the baseline quantitative scenario in this report. In that scenario, GNP would shrink in 1991 and 1992 and would grow in most of the region until 1993. By 1995, annual growth would average just over 3 percent, assuming that there were no further adverse external shocks and that the pace of economic reform were to be maintained.

For potential investors into the region, this less-than-bright outlook raises serious concern about the sustainability of the reforms: Will protracted and widespread economic hardship undermine public acceptance of the reform process?

To reduce such a risk, economic reforms should in general be accelerated. In the countries that have not already done so, there is every reason to completely liberalize trade, to establish open rules and procedures for foreign investment, and to opt quickly for currency convertibility at a single, realistic exchange rate. Immediate steps that would strengthen the financial sector include permitting foreign competition and strengthening the balance sheets of newly established banks. Interest rate deregulation should also proceed in a timely way. More difficult, but equally urgent, steps include pressing ahead with privatization and closing moribund businesses, which act as brakes on the region's economies. Although they might actually increase dislocation and hardship in the very short run, such measures would increase economic efficiency more quickly and would improve the mobilization and allocation of domestic resources, thereby hastening the day when growth could resume.

To examine the possible ramifications of increasing the pace of reform, this study includes a second quantitative scenario. Although accelerated reform would increase financing needs, it should also boost the region's absorptive capacity for external financing, encourage official support from abroad and attract greater financial inflows from the private sector. Because of these associated effects, the probable gains — in terms of faster growth and increased foreign financing — might be quite substantial. If the pace of reform were accelerated, the alternative scenario suggests that GNP might rebound vigorously in 1993 and that the region's average annual rate of growth could exceed 5 percent by 1995.

In the baseline scenario, the need for external financing would rise from $38 billion in 1991 to $56 billion in 1995. Although the current account balance of the region as a whole would improve from a deficit of roughly $12 billion to one of about $8 billion, amortization due on medium- and long-term debt (before debt reduction) would rise from $10 billion to about $17 billion. And as trade with the industrial countries expanded, the amortization of short-term credits would double to about $28 billion.

Availability of Financing

This level of financing seems feasible. In the past two years, the response from both private and public sources of financing has been encouraging. The region's reform programs have clearly captured the hope and goodwill of the industrial countries. Nonetheless, that should not be misinterpreted to mean that industrial countries' governments and private enterprises plan large-scale financing flows to Eastern Europe in the near future. In particular, the relatively large pledges of capital inflows to the former German Democratic Republic (GDR) from the Federal Republic of Germany and other industrial countries should not be used as points of reference. In fact, in the near term the scope of useful and available assistance is dwarfed by the scale of the systemic transformation the region is undergoing.

The short term prospects for inflows of private capital seem limited, even under the best of circumstances. Some capital flows have been diverted to East Germany by the relatively favorable opportunities there, while in Eastern Europe bureaucratic obstacles to investment remain — as much in the way policies are implemented as in the policies themselves. Some promising investments have failed to materialize because of either unrealistic government requirements or uncertainties about the transactions' terms and conditions — or even about the parties thereto. In short, deals are hard to do.

In any case, apparently few opportunities are profitable enough to warrant incurring the difficulties and risks involved. Language barriers, poor infrastructure and environmental problems will continue to inhibit inflows of private capital to Eastern Europe. Uncertainty persists regarding the ownership and control of assets and the rights of foreign investors in the event of disputes. And the value of assets is hard to ascertain because, for the moment, there are neither historical accounts nor previous market-determined prices with which the inputs and outputs of enterprises can be valued.

Foreign banks' lending to local enterprises — both private and state-owned, with and without sovereign guarantees — would rise only modestly over the next five years in the baseline scenario. Disbursements of medium- and long-term credit from industrial countries' commercial banks, together with the proceeds of international debt market financings, would increase from $2 billion in 1991 to $5 billion in 1995. European banks may provide most credit, as export finance or as cofinancing with official agencies. Individual enterprises and governments in the region may borrow directly in the capital markets of industrial countries, but — recent examples notwithstanding — the resulting capital inflows will probably be limited. Portfolio investment directly into regional enterprises and into the nascent domestic capital markets should rise slowly from a nearly non-existent base. And, although several direct foreign investments have been announced, some have been started, and more will undoubtedly be made, the associated capital inflows are expected to materialize gradually, over a period of years.

In the baseline scenario, total disbursements of medium- and long-term credit from both official and private sources would rise from about $13 billion to $18 billion for the region as a whole between 1992 and 1995. In addition, equity inflows would rise from about $1 billion in 1991 to about $2.5 billion in 1995, for a total of $9 billion in new portfolio and direct investment over the next five years.

Faster reform should be associated with faster growth and a faster buildup of external financing. Initially, official financing sources would have to meet the incremental need.

Under the accelerated reform scenario, disbursements of official medium- and long-term financing in 1993 and on into 1994 would be 15 percent higher than in the baseline scenario. It should be emphasized that, in view of the time needed to gear up aid programs, a 1993 rise in disbursements of this magnitude is premised on reform's being accelerated very soon. The increase in disbursements would then taper off to just 5 percent above that of the baseline scenario in 1995, when the reforms should have progressed sufficiently to induce substantial increases in private capital inflows, both of debt and equity financing.

In the accelerated reform scenario, private lending would rise from $3 billion in 1993 to $7 billion in 1995, and foreign direct investment would surge from $2 billion in 1993 to more than $7 billion by 1995. Thus, in this second scenario, private equity flows and direct foreign investment would total more than $15 billion for the five years between 1991 and 1995.

These private inflows may well seem small in relation to the region's overall needs for capital. Based on rough current valuations, the privatization programs of the individual nations would seem more than capable of absorbing sums of this magnitude by themselves. But these estimates of the value of state assets to be privatized may have to be revised downward. Certainly, the pace of privatization should not be slowed in an attempt to realize preconceived prices for state assets. A better course would be to redouble efforts to mobilize domestic resources, which underscores the importance of reforming the region's financial sectors.

The governments of the region should press on in their efforts to encourage private capital inflows in general, and direct foreign investments in particular, no matter how small they are at this time. As these governments have well recognized, foreign companies bring with them technology, management skills and entree to the markets of the industrial countries. Perhaps more importantly, the measures needed to encourage direct foreign investments are the self-same measures needed to create flourishing private sectors domestically.

External Responsibilities

At first, the bulk of the capital inflows will have to come from official agencies. It is crucial that this external assistance be well designed and truly needed. And, except for humanitarian aid, it should be provided only to those countries making serious and sustained efforts to reform.

This report has sketched the relationship between reform, external financing flows and sustainable economic growth. The industrial countries and the multilateral agencies must articulate this relationship more fully in the course of their policy discussions with the governments of the region and should be prepared to commit themselves to providing additional funding if reform is accelerated.

Full use should be made of the multilateral institutions, which can draw on international capital markets to raise funds, thereby avoiding explicit budgetary problems that would be politically difficult to address in some of the industrial countries at this time. The multilateral institutions will play a crucial role not only in providing private sector and structural adjustment financing, but also in extending technical assistance and helping to prepare the ground for the inflow of the significant amounts of private capital needed if the region is to achieve its full economic potential.

Finally, it should be emphasized that the industrial countries must do everything possible to liberalize access to their markets for East European exports. This is particularly important for agricultural products. And, as a necessary result of proximity, the greatest benefits for Eastern Europe may well come from any measures that the European Community is able to enact on this score.

The Need for Quick Action

The countries of Eastern Europe have about two years — three, at the most — to make irrevocable changes in their economic systems. The reform process will undoubtedly last somewhat longer, but unless most of the fundamental reforms are in place early on, the whole process of transformation may be jeopardized and inflows of foreign capital inhibited. The individuals bearing the burden of the inevitably higher unemployment rates and lower standards of living during the transition will likely run out of patience if no improvements are in sight. Without support, measures to accelerate growth and the inflow of private capital could be put off indefinitely, and the impetus to fully bind the countries of the region into the international economic system might weaken.

The process has a good chance of being carried through successfully, provided reform is accelerated and external support is sufficient. Although the industrial countries did not dare to hope for the political about-face that has occurred in Eastern Europe in the past two years, the entire world stands to benefit substantially if the region can become prosperous, stable, and well integrated into the international economy. The industrial countries, therefore, have a strong interest in opening their markets and extending generous help. And the governments of the region have a strong interest in pressing ahead with the transformation. Together, they must hold firm to their vision and commitment to meet this historic challenge.

Annex 1
The Quantitative Analysis

This annex reviews the technically important assumptions that were used in the quantitative analysis but not discussed in the main text.

The Analytical Approach

The same analytical framework — a one-gap model — was used to analyze the external financial needs and sources for all six countries in the region.

In broad terms, this model takes a domestic economic growth scenario and derives from it a forecast of imports; takes a foreign growth scenario and derives a forecast of exports; and after an adjustment for the servicing of past capital flows, produces a forecast of the current account balance. This, together with the amortization due on past short-, medium- and long-term foreign debt, adds up to the total financing uses each year.

The corresponding financing resources are made up of disbursements of short-, medium- and long-term debt, private foreign investment, debt relief and changes in reserves.

The baseline scenario is summarized in 13 tables in this annex. Table A1 analyzes the direction of trade for the six countries in 1989 and provides the basis for separate forecasts of future trade with the Soviet Union and the rest of the world in the baseline scenario for the individual countries. Tables A2 through A13 include two tables for each country:

The first table in each pair summarizes financing sources and needs from 1991 to 1995. The second summarizes the corresponding cumulative debt and investment positions and the net investment position of each country.

Assumptions about economic growth are discussed in the main text.

The Assumptions for Financing Needs

Trade

The exports of goods and services to the industrial countries are driven by an assumption that the share of exports from the six in industrial country imports would rise quite rapidly, by about 50 percent a year. The G-5 — the United States, France, Germany, Japan and the United Kingdom — represent the industrial countries in this quantitative analysis. The rate of share increase is somewhat lower for Yugoslavia — which for some time has been more integrated in world trade than the other five — and Poland; it is slightly higher for Hungary. A growth rate 50 percent above G-5 average trade growth corresponds to an elasticity of about 3.5 for real exports with respect to real G-5 economic growth — about twice that of the G-5 among themselves.

Imports of goods and services (excluding interest payments) from the industrial countries are assumed to rise gradually as a percent of nominal GNP. In Bulgaria, for example, the increase is such that, over the forecast period, real imports rise about two times faster than real GNP; the elasticity of imports with respect to GNP is two.

Exports and imports of goods and services to the Soviet Union are assumed to grow with Soviet GNP except in 1991, when they are expected to fall 20 percent in nominal terms, reflecting not only the anticipated sharp drop in Soviet GNP, but also some additional disruption in trading relationships. (Recent indications indicate that this may be a conservative estimate of the decline in trade due to the collapse of the Soviet economy.) Non-fuel imports for each of the six from the Soviet Union are expected to rise with GNP, *i.e.*, with an import elasticity of one. Oil and natural gas imports from all sources are forecast to increase with real GNP in the six countries of the region.

As Table A1 makes clear, trade among the six was well balanced prior to the terms-of-trade changes in the CMEA. The working assumption is that the composition of trade among them was also sufficiently well balanced that net trade balances among them would remain very small, even after the terms-of-trade changes take effect. From the viewpoint of calculating the future financing requirements — and only from that viewpoint — trade between the six can be neglected.

Interest Payments

Interest payments on both official and non-official debt average a fixed margin over the London Interbank Offer Rate (LIBOR). It is assumed that the World Bank, EBRD and IMF interest rates are equal to LIBOR on average. The interest rate on other official creditors is assumed to be 1 percent over LIBOR. For commercial lending by banks, the margin over LIBOR varies with the borrowing country, depending on its perceived access to the loan market, which was taken to be greatest for the CSFR; less for Hungary and Yugoslavia; and least for Poland and Bulgaria. Romania's future debt is assumed to be incurred at the same margin over LIBOR as the CSFR's, even though it is not active in credit markets at the moment, because it has so little debt now.

Transfer Payments

Transfer payments, such as remittances from abroad and payments to relatives, are forecast to be stable in real terms in Hungary, Poland and Bulgaria. They rise with imports in Yugoslavia, reflecting the importance of remittances to that economy. They increase from a very low level — a few million dollars — in increments of $10 million or so in Romania. And they rise in increments of $25 million or so in the CSFR, where they have been negative in the past two years.

Amortization

Amortization due reflects previous borrowing and anticipated disbursements of medium- and long-term debt. The terms are assumed to be average:

- Four years' grace and 13 years' repayment for World Bank and European Bank for Reconstruction and Development (EBRD) lending;
- One year's grace and three years' repayment for IMF programs;
- Two years' and six years' repayment for bilateral official medium- and long-term aid; and
- One year's grace and six years' repayment for commercial lending.

Short-term debt is repaid the year after it is incurred.

The Assumptions for Financing Sources

The main text discusses financing sources except for the change in reserves. Generally, reserves were assumed to approach three months of imports by 1995. In Bulgaria, they rose to only one month, reflecting anticipated continuing difficulties in the balance of payments.

Table A1. Direction of Trade in the Region in 1989

	Exports (US$ billions) From			
	Bulgaria	*CSFR*	*Hungary*	*Poland*
Exports to:				
Bulgaria		0.35	0.11	0.26
CSFR	0.23		0.59	0.79
Hungary	0.11	0.49		0.29
Poland	0.17	0.62	0.23	
Romania	0.48	0.52	0.19	0.18
Yugoslavia	0.14	0.45	0.36	0.34
USSR	2.31	1.39	2.89	3.27
East Germany	0.32	0.35	0.61	0.58
Sub-Total	3.75	4.15	4.97	5.70
Rest of the World	0.86	2.79	5.08	7.40
Total	4.61	6.93	10.05	13.10

Note: These estimates are based largely on the IMF's 1990 "Direction Of Trade Statistics Yearbook." The exceptions are the trade flows between the Soviet Union, Bulgaria and East Germany, which are Secretariat estimates and are added to the DOTS totals. The comparatively small flows between Bulgaria and the CSFR have also been estimated, by altering the DOTS total—subtracting the estimated flows from the "Rest of the World."

Exports (US$ billions) From						
Romania	*Yugoslavia*	*USSR*	*East Germany*	*Sub-Total*	*Rest of the World*	*Total*
0.34	0.13	4.94	0.66	6.80	1.45	8.24
0.53	0.40	1.54	0.39	4.47	3.25	7.72
0.14	0.29	2.22	0.59	4.12	5.93	10.05
0.15	0.43	2.63	0.50	4.72	5.33	10.05
	0.12	3.52	0.91	5.90	3.86	9.75
0.14		2.04	0.29	3.76	11.08	14.83
4.34	2.70		11.59	28.48	40.30	68.78
0.86	0.31	11.87		14.90	4.26	19.16
6.51	4.38	28.76	14.92			
7.76	9.08	23.15	2.77			
14.27	13.46	51.91	17.69			

Table A2. Bulgaria: Sources and Uses of External Funds
(US$ billions)

	1991	*1992*	*1993*	*1994*	*1995*	*1991-1995*
Uses of Funds	**-5.0**	**-4.4**	**-4.8**	**-4.9**	**-5.0**	**-24.1**
Current Account Balance	-2.2	-1.7	-1.9	-1.7	-1.6	-9.0
Trade Balance	-1.1	-0.8	-1.0	-0.9	-0.9	-4.6
Interest Payments	-1.2	-1.1	-1.0	-0.9	-0.8	-5.0
Net Transfers	0.1	0.1	0.1	0.1	0.1	0.5
Amortization Payments	-2.9	-2.6	-2.8	-3.1	-3.1	-14.5
Accumulation of Reserves	0.0	-0.1	-0.1	-0.1	-0.3	-0.6
Sources of Funds	**5.0**	**4.4**	**4.8**	**4.9**	**5.0**	**24.2**
Debt Financing	2.2	2.2	2.5	2.5	2.6	12.0
Long-Term	0.9	0.7	0.8	0.9	1.2	4.5
Official	0.8	0.7	0.7	0.8	1.0	4.1
Multilateral	0.6	0.4	0.5	0.5	0.7	2.7
Bilateral	0.2	0.2	0.3	0.3	0.3	1.3
Private	0.1	0.1	0.1	0.1	0.1	0.4
Short-Term	1.3	1.5	1.7	1.6	1.4	7.5
Equity Financing	0.0	0.1	0.1	0.2	0.2	0.6
Assumed Debt Relief	2.8	2.1	2.2	2.2	2.3	11.6
Memo Items						
Net Financial Flows	2.1	1.8	2.0	1.8	1.9	9.7
Net Real Transfers	0.9	0.8	1.0	0.9	1.1	4.7

Table A3. Bulgaria: Net Investment Position
(US$ billions)

	1991	*1992*	*1993*	*1994*	*1995*
Outstanding Debt	**9.5**	**9.2**	**8.9**	**8.2**	**7.7**
Long-Term	6.3	5.8	5.3	4.8	4.4
Official	2.1	2.2	2.3	2.5	2.7
Multilateral	1.1	1.2	1.3	1.4	1.6
Bilateral	1.0	1.0	1.1	1.1	1.1
Private	4.2	3.6	2.9	2.3	1.7
Short-Term	3.2	3.4	3.6	3.5	3.3
Outstanding Equity (1991 onward)	2.2	4.4	6.9	9.4	12.0
Debt Service	**2.8**	**2.3**	**2.3**	**2.3**	**2.4**
Debt Service Ratio	42%	36%	34%	31%	29%
Debt/GNP	28%	27%	29%	31%	32%

Table A4. CSFR: Sources and Uses of External Funds
(US$ billions)

	1991	*1992*	*1993*	*1994*	*1995*	*1991-1995*
Uses of Funds	**-6.6**	**-8.4**	**-9.6**	**-10.7**	**-11.5**	**-46.7**
Current Account Balance	-2.5	-2.5	-2.0	-2.2	-2.0	-11.3
Trade Balance	-1.7	-1.4	-0.6	-0.7	-0.3	-4.7
Interest Payments	-0.8	-1.2	-1.4	-1.6	-1.8	-6.8
Net Transfers	0.0	0.0	0.0	0.1	0.1	0.2
Amortization Payments	-2.6	-5.2	-6.8	-7.9	-9.0	-31.6
Accumulation of Reserves	-1.5	-0.7	-0.8	-0.5	-0.4	-3.8
Sources of Funds	**6.6**	**8.4**	**9.6**	**10.7**	**11.5**	**46.7**
Debt Financing	6.5	8.2	9.3	10.3	11.0	45.3
Long-Term	2.4	2.9	3.3	3.9	4.6	17.0
Official	2.0	2.0	2.1	2.5	2.9	11.5
Multilateral	1.7	1.0	0.9	1.0	1.1	5.7
Bilateral	0.3	0.9	1.2	1.5	1.8	5.8
Private	0.4	0.9	1.2	1.4	1.7	5.6
Short-Term	4.1	5.3	6.0	6.4	6.4	28.3
Equity Financing	0.1	0.3	0.3	0.4	0.4	1.4
Memo Items						
Net Financial Flows	3.9	3.2	2.8	2.7	2.5	15.1
Net Real Transfers	3.2	2.1	1.3	1.1	0.7	8.4

Table A5. CSFR: Net Investment Position
(US$ billions)

	1991	*1992*	*1993*	*1994*	*1995*
Outstanding Debt	**11.0**	**13.9**	**16.4**	**18.7**	**20.8**
Long-Term	5.9	7.6	9.4	11.3	13.4
Official	3.1	4.3	5.5	6.8	8.1
Multilateral	1.9	2.4	2.7	2.9	3.1
Bilateral	1.2	1.9	2.8	3.8	5.0
Private	2.8	3.3	3.9	4.6	5.3
Short-Term	5.1	6.3	7.0	7.4	7.4
Outstanding Equity (1991 onward)	**0.1**	**0.3**	**0.6**	**1.0**	**1.4**
Debt Service	**1.4**	**2.3**	**2.9**	**3.6**	**4.4**
Debt Service Ratio	17%	25%	29%	31%	33%
Debt/GNP	9%	11%	13%	13%	14%

Table A6. Hungary: Sources and Uses of External Funds
(US$ billions)

	1991	*1992*	*1993*	*1994*	*1995*	*1991-1995*
Uses of Funds	**-8.0**	**-8.0**	**-8.8**	**-9.6**	**-11.4**	**-45.9**
Current Account Balance	-1.2	-0.9	-0.6	-0.5	0.6	-2.7
Trade Balance	0.5	0.9	1.2	1.1	2.1	5.8
Interest Payments	-2.2	-2.4	-2.3	-2.2	-2.2	-11.3
Net Transfers	0.5	0.6	0.6	0.6	0.6	2.8
Amortization Payments	-5.8	-6.9	-7.9	-8.8	-9.7	-39.1
Accumulation of Reserves	-1.0	-0.1	-0.3	-0.4	-2.4	-4.2
Sources of Funds	**8.0**	**8.0**	**8.8**	**9.6**	**11.4**	**45.9**
Debt Financing	7.6	7.3	8.0	8.7	10.3	41.9
Long-Term	3.7	2.7	3.1	3.8	4.6	17.9
Official	3.0	1.9	2.1	2.5	3.0	12.6
Multilateral	2.6	1.3	1.4	1.6	1.9	8.8
Bilateral	0.5	0.6	0.7	0.9	1.1	3.7
Private	0.7	0.8	1.0	1.3	1.6	5.4
Short-Term	4.0	4.6	4.8	4.9	5.7	24.0
Equity Financing	0.4	0.7	0.8	1.0	1.1	4.0
Memo Items						
Net Financial Flows	2.2	1.0	0.9	0.9	1.8	6.8
Net Real Transfers	0.1	-1.3	-1.4	-1.4	-0.4	-4.4

Table A7. Hungary: Net Investment Position
(US$ billions)

	1991	*1992*	*1993*	*1994*	*1995*
Outstanding Debt	**22.0**	**22.3**	**22.4**	**22.3**	**23.0**
Long-Term	19.2	18.9	18.8	18.6	18.5
Official	6.6	7.5	8.4	9.2	10.0
Multilateral	4.8	5.3	5.8	6.2	6.3
Bilateral	1.8	2.2	2.6	3.1	3.7
Private	12.6	11.4	10.4	9.4	8.5
Short-Term	2.8	3.4	3.6	3.7	4.5
Outstanding Equity (1991 onward)	**0.4**	**1.1**	**2.0**	**2.9**	**4.0**
Debt Service	**4.4**	**5.4**	**5.6**	**6.2**	**6.9**
Debt Service Ratio	34%	38%	37%	36%	36%
Debt/GNP	34%	33%	30%	28%	27%

Table A8. Poland: Sources and Uses of External Funds
(US$ billions)

	1991	*1992*	*1993*	*1994*	*1995*	*1991-1995*
Uses of Funds	**-8.5**	**-10.2**	**-11.0**	**-11.1**	**-11.8**	**-52.7**
Current Account Balance	-2.8	-3.4	-3.9	-3.4	-2.9	-16.3
Trade Balance	0.5	0.7	-0.3	-0.3	0.0	0.7
Interest Payments	-4.9	-5.7	-5.4	-5.0	-4.8	-25.8
Net Transfers	1.6	1.7	1.8	1.8	1.9	8.8
Amortization Payments	-5.6	-6.5	-6.6	-7.3	-8.5	-34.6
Accumulation of Reserves	-0.1	-0.3	-0.5	-0.4	-0.4	-1.8
Sources of Funds	**8.5**	**10.2**	**11.0**	**11.1**	**11.8**	**52.7**
Debt Financing	5.5	4.9	5.6	6.2	7.1	29.4
Long-Term	2.5	1.8	2.0	2.2	2.6	11.0
Official	2.5	1.7	1.9	2.0	2.3	10.3
Multilateral	2.0	1.2	1.3	1.4	1.6	7.5
Bilateral	0.4	0.5	0.6	0.6	0.7	2.8
Private	0.1	0.1	0.1	0.2	0.3	0.7
Short-Term	3.0	3.1	3.6	4.1	4.5	18.3
Equity Financing	0.1	0.2	0.2	0.3	0.3	1.1
Assumed Debt Relief	2.9	5.1	5.2	4.6	4.5	22.3
Memo Items						
Net Financial Flows	2.9	3.7	4.4	3.8	3.3	18.1
Net Real Transfers	-2.0	-2.0	-1.0	-1.2	-1.5	-7.7

Table A9. Poland: Net Investment Position

(US$ billions)

	1991	*1992*	*1993*	*1994*	*1995*
Outstanding Debt	**53.1**	**51.5**	**50.5**	**49.4**	**48.0**
Long-Term	50.2	48.4	46.9	45.4	43.5
Official	42.1	40.5	39.1	37.9	36.2
Multilateral	5.4	6.3	7.3	8.2	9.1
Bilateral	36.6	34.1	31.9	29.7	27.1
Private	8.1	7.9	7.8	7.5	7.3
Short-Term	2.9	3.1	3.6	4.0	4.5
Outstanding Equity (1991 onward)	**0.1**	**0.3**	**0.5**	**0.8**	**1.1**
Debt Service	**8.3**	**9.3**	**8.9**	**8.7**	**9.2**
Debt Service Ratio	48%	52%	46%	40%	39%
Debt/GNP	33%	32%	31%	31%	23%

Table A10. Romania: Sources and Uses of External Funds

(US$ billions)

	1991	*1992*	*1993*	*1994*	*1995*	*1991-1995*
Uses of Funds	**-2.5**	**-3.4**	**-3.9**	**-4.7**	**-5.1**	**-19.7**
Current Account Balance	-1.8	-1.9	-1.1	-1.5	-1.2	-7.5
Trade Balance	-1.9	-1.7	-0.8	-1.1	-0.6	-6.0
Interest Payments	-0.1	-0.3	-0.5	-0.6	-0.7	-2.1
Net Transfers	0.1	0.1	0.1	0.1	0.1	0.6
Amortization Payments	-0.3	-1.5	-2.7	-3.0	-3.8	-11.3
Accumulation of Reserves	-0.4	-0.1	-0.1	-0.2	-0.2	-0.9
Sources of Funds	**2.5**	**3.4**	**3.9**	**4.7**	**5.1**	**19.7**
Debt Financing	2.5	3.4	3.8	4.6	5.0	19.3
Long-Term	1.4	1.1	1.6	1.9	2.1	8.0
Official	1.3	1.1	1.4	1.5	1.7	7.1
Multilateral	1.2	0.7	0.7	0.7	0.7	4.0
Bilateral	0.2	0.4	0.7	0.8	1.0	3.1
Private	0.0	0.1	0.2	0.3	0.3	0.9
Short-Term	1.2	2.2	2.3	2.7	2.9	11.3
Equity Financing	0.0	0.1	0.1	0.1	0.2	0.5
Memo Items						
Net Financial Flows	2.2	1.9	1.2	1.7	1.3	8.4
Net Real Transfers	2.2	1.7	0.7	1.2	0.6	6.4

Table A11. Romania: Net Investment Position
(US$ billions)

	1991	*1992*	*1993*	*1994*	*1995*
Outstanding Debt	**2.7**	**4.6**	**5.7**	**7.3**	**8.5**
Long-Term	1.7	2.5	3.5	4.7	5.7
Official	1.5	2.2	3.1	4.0	4.8
Multilateral	1.2	1.6	1.9	2.1	2.1
Bilateral	0.3	0.6	1.3	2.0	2.7
Private	0.2	0.2	0.4	0.6	0.8
Short-Term	1.0	2.1	2.1	2.6	2.8
Outstanding Equity (1991 onward)	**0.0**	**0.1**	**0.2**	**0.3**	**0.5**
Debt Service	**0.1**	**0.6**	**1.0**	**1.3**	**1.8**
Debt Service Ratio	2%	13%	17%	20%	24%
Debt/GNP	4%	6%	8%	9%	10%

Table A12. Yugoslavia: Sources and Uses of External Funds
(US$ billions)

	1991	*1992*	*1993*	*1994*	*1995*	*1991-1995*
Uses of Funds	**-7.6**	**-9.0**	**-9.4**	**-10.5**	**-11.7**	**-48.2**
Current Account Balance	-1.1	-1.2	-0.1	-0.3	-0.4	-3.2
Trade Balance	-0.2	-0.3	0.9	0.5	0.4	1.3
Interest Payments	-2.2	-2.3	-2.5	-2.3	-2.4	-11.7
Net Transfers	1.3	1.4	1.4	1.5	1.6	7.2
Amortization Payments	-6.9	-7.4	-9.0	-9.5	-10.5	-43.4
Accumulation of Reserves	0.5	-0.4	-0.3	-0.7	-0.7	-1.6
Sources of Funds	**7.6**	**9.0**	**9.4**	**10.5**	**11.7**	**48.2**
Debt Financing	7.4	8.7	9.2	10.2	11.4	46.8
Long-Term	1.8	1.7	1.8	2.1	2.4	9.8
Official	1.3	1.2	1.2	1.3	1.5	6.4
Multilateral	0.8	0.7	0.6	0.7	0.8	3.5
Bilateral	0.4	0.5	0.6	0.6	0.7	2.9
Private	0.5	0.6	0.7	0.8	0.9	3.4
Short-Term	5.6	7.0	7.3	8.2	9.0	37.0
Equity Financing	0.3	0.3	0.3	0.3	0.3	1.4
Memo Items						
Net Financial Flows	0.7	1.6	0.4	1.0	1.1	4.8
Net Real Transfers	-1.5	-0.7	-2.1	-1.3	-1.3	-6.9

Table A13. Yugoslavia: Net Investment Position

(US$ billions)

	1991	*1992*	*1993*	*1994*	*1995*
Outstanding Debt	**21.0**	**23.1**	**23.2**	**23.9**	**24.7**
Long-Term	17.7	18.3	18.1	18.0	18.0
Official	10.3	10.8	10.6	10.7	10.9
Multilateral	4.3	4.3	4.3	4.5	4.9
Bilateral	6.0	6.5	6.3	6.2	6.1
Private	7.4	7.6	7.5	7.3	7.1
Short-Term	3.3	4.7	5.0	5.9	6.7
Outstanding Equity (1991 onward)	**7.6**	**16.6**	**26.0**	**36.6**	**48.2**
Debt Service	**4.0**	**4.1**	**4.5**	**4.5**	**4.8**
Debt Service Ratio	21%	20%	20%	18%	17%
Debt/GNP	16%	18%	17%	17%	16%

Annex 2
Doing Business in Eastern Europe

Many industrial country businesses that suspect they may have opportunities in Eastern Europe are still unsure of the specific conditions they face. There are several standard strategic issues on which judgments have to be made, before the businesses commit to trade, invest, or otherwise operate in the region. The issues can be grouped under five headings:

- *Start-up.* What sorts of clearance are needed to start an operation, and how long do they take?
- *Policy Incentives and Disincentives.* What preconditions may be imposed on operations: export targets, employment, use of particular facilities or materials? Equally, what incentives to invest exist: tax holidays, protection from foreign competition, preferential access to imports and the like? How are ownership rights established, and how far do they extend? What obligations — such as for environmental cleanup — may carry over from previous owners?
- *The Business Environment.* How reliable is the infrastructure needed to support operations? What is the tax regime? How are commercial disputes settled? How reliable are services? What is the availability of labor?
- *Foreign Exchange.* What are the rules governing the availability of foreign exchange and repatriation of fees, royalties and profits?
- *Commercial Prospects.* Given judgments on these questions and

the economic outlook, what are the prospects for profit and how much risk is there?

This annex addresses the first four of these strategic issues, which concern the local business conditions. The annex reviews available information country by country.

Bulgaria

In recent years, the Bulgarian government has been actively seeking joint ventures with Western firms. Foreign interest in investing in Bulgaria is constrained by its relatively small internal market and few natural resources. The Foreign Trade Bank's suspension of payments on Bulgaria's hard-currency debt — including short-term debt — to commercial banks in March 1990 and the subsequent failure to resolve the problem (as of May 1990) provided another deterrent for foreign investors.

Start-up

A feasibility study is required before entering into formal negotiations to establish a joint venture.

Decree 56, adopted in January 1989, allows wholly foreign-owned ventures. A permit is required from the appropriate ministry, however, if foreign ownership exceeds 20 percent of the shares in a joint stock company and 49 percent of a limited liability company.

Foreign investment is permitted in all sectors of the economy except where national security (not defined) is concerned.

Policy Incentives and Disincentives

Foreigners can be directors and managers of companies. However, management of a joint venture operates under a two-tier system with a board of directors and a managing board. All decisions of the managing board must be unanimous, thereby giving the Bulgarian partner veto power over operational decisions. The chairman of both boards must be

Bulgarian, although this is negotiable in cases of majority foreign ownership.

Foreign firms may not own land, but they may acquire the right to use land for as long as they operate in Bulgaria.

Company profits are subject to a 50 percent tax rate. Companies with more than 20 percent foreign ownership are subject to a 30 percent rate. Income earned during the first five years of operations in a duty free zone is exempt from tax; the rate is 20 percent thereafter.

Duty free zones have been established in Vidin, Ruse, Plovdiv, Varna and Burgas

Imports for processing for export are duty free.

The Business Environment

Decree 56 made companies liable to bankruptcy. It also ended the government's monopoly on foreign trade, and now all companies have the right, in theory, to conduct foreign trade.

Most retail prices and wages continue to be controlled by the government.

Company profits are subject to a 50 percent tax rate. There is a 15 percent withholding tax on dividends, interest and royalties leaving the country.

Foreign Exchange

Foreign owned joint ventures can keep all hard currency earnings and can have foreign currency bank accounts.

Only hard currency profits can be repatriated now because of Bulgaria's balance-of-payments problems. It is not clear when repatriation of local profits will be permitted.

The Czech and Slovak Republic

In 1985, the Czechoslovak government approved the concept of joint ventures with Western firms. Previously, joint ventures were limited to

CMEA countries. A new joint venture law went into effect January 1, 1989. By June 1989, 20 joint ventures involving Western partners had been set up, with half of them in the tourism sector (joint ventures in services and tourism were expressly forbidden until February 1987).

The law was amended in April 1990, and in the following three months some 220 applications were submitted to the Federal Ministry of Finance. Most were small (64 percent had under $30,000 initial investment); the joint stock company was the most common form, followed by trade associations with limited partnerships; and more than three-quarters were located in the Czech Republic, which is perceived by Western investors as having a higher level of development and being closer to potential export markets, in comparison to the Slovak Republic.

Start-up

Enterprises with foreign participation need approval from the Ministry of Finance. Banks with foreign participation need approval from the CSFR State Bank. A decision on the application will be made within 60 days.

Under current law, it is possible for a foreign partner in a joint venture to own a majority of the company, up to 100 percent (negotiated on a case-by-case basis).

Policy Incentives and Disincentives

There is a lower rate of taxation on joint ventures than on domestic firms (40 percent rather than 50 percent). The finance minister may also grant a two-year exemption from the profits tax, with smaller exemptions for an undefined period thereafter.

Existing law does not guarantee that local currency profits will be converted into hard currency. This means that although the law does not explicitly limit the areas in which joint ventures may operate, for all practical purposes they are limited to the export sector.

Dividends are subject to a 25 percent tax rate. Corporate income is taxed at a 20 percent rate if income is 200,000 Crowns or less ($12,000). Income above 200,000 Crown is subject to a 40 percent rate.

The CSFR adheres to the same multilateral intellectual property conventions as does the United States.

Foreign Exchange

Thirty percent of the foreign currency earnings must be sold to the CSFR State Bank. With the permission of the State Bank, an enterprise with foreign participation can open a foreign currency bank account and obtain foreign currency credit.

Profits can be repatriated only if the enterprise holds the necessary foreign currency in local bank accounts. Capital can be repatriated freely in the currency in which the investment was made.

Hungary

The Hungarian government is actively promoting foreign investment in Hungary to aid in the restructuring of its economy. Despite the commitment to building a genuine market economy, however, Hungary is still a largely non-market economy with state ownership of the most productive property.

Start-up

Joint ventures, subsidiaries and equity acquisitions with less than 50 percent foreign participation need only register with a central court of registration prior to establishment.

In 1989 the average wait for registration was 4 to 6 weeks. In January 1990 the Hungarian government took steps to speed up the process by doubling the number of registrars and simplifying the old forms, which were devised before World War II. Licenses are likely to be granted more quickly to projects that earn hard currency through exports than to those that aim at the domestic market.

Foreigners can own 100 percent of a newly-established joint venture, set up a wholly-owned subsidiary, or purchase all the shares of an existing state enterprise. Sole shareholding is permitted in a limited liability company, whereas there must be at least two shareholders in a joint stock company.

There is no minimum required level of foreign investment, but there are minimum capitalization requirements (joint stock company, 10 million forints with shares having a nominal value of not less than 10,000 forints each; limited liability company, 1 million forints).

Policy Incentives and Disincentives

Foreigners may open and maintain hard currency accounts in commercial banks. If part of a foreign partner's equity contribution to a joint venture is in cash, he may hold it in a hard currency account with no obligation to transfer it into forints, and he has instant access to it to buy land or machinery for business purposes.

A joint venture may acquire real property necessary for the conduct of its business. Purely speculative acquisitions of land and the establishment of real estate companies are not allowed.

Capital goods, technologies, patents, and the like brought into a joint venture as in-kind contributions, as well as those purchased with hard-currency from an original cash contribution, enjoy duty-free entry into Hungary.

Employers, including foreign joint ventures, must pay a 43 percent social security tax on the gross salaries of Hungarian nationals. No social security tax is payable on foreign employees, unless they wish to participate in Hungary's state-provided social insurance and health care services, which are available to individuals free of charge.

Hungary still maintains some restrictions on salaries and bonuses payable to employees. Companies that are at least 20 percent foreign owned are exempted from such restrictions.

Tax holidays are available for up to five years. Any joint venture with foreign participation equal to or greater than 5 million forints, or 20 percent of total equity, can get a 20 percent tax reduction. Larger joint ventures and those involving hotel construction and operation can get a 60 percent reduction for five years and a 40 percent reduction thereafter. Joint ventures in certain priority sectors (such as telecommunications, computers, and machine tools) can obtain a 100 percent tax holiday for five years and a 60 percent reduction thereafter.

The Business Environment

The corporate tax rate on the first 3 million forints of taxable income is 35 percent. Income above this amount is subject to a 40 percent rate. There is no withholding tax on corporate dividends.

There are serious infrastructural shortcomings. Simple domestic banking transactions can be much more time-consuming than in the West, international transactions can take weeks to complete, and errors are common. The telecommunications network is based largely on 1950s technology, making even simple telephone connections problematic. There are as many people on the waiting list for connections as there are subscribers.

Hungarian law no longer differentiates among companies operating in Hungary, whether state-owned, private or joint venture.

It is very common for Hungarians to work at two or even three jobs to make ends meet. This practice tends to reduce labor productivity. Foreign companies have overcome this problem by paying wages above the prevailing norm while prohibiting moonlighting.

Private firms can hire up to 500 employees. The ceiling in effect prior to January 1, 1990, was 30 employees.

The law provides for compensation in the currency of the original investment for confiscation, nationalization, expropriation or equivalent measures (although the law is vague on how the value of an investment would be determined in case of a seizure of assets).

Foreign Exchange

Joint ventures are not permitted to retain hard currency earned through exporting. These funds must be transferred into a forint account in the National Bank of Hungary. At year-end, the foreign partner's share may be transferred back into hard currency and repatriated. One drawback in this arrangement is that the foreign partner will receive less foreign exchange than was earned by the original export if the Hungarian government devalues the forint before year-end.

Hard currency export earnings may be used to import raw materials or equipment. If the item is on a liberalized list (which included 65 percent of all items imported by value in 1990 and 80-85 percent in 1991) the necessary foreign exchange may be obtained by reconverting the necessary sums from the export earnings forint account without special permission from the authorities. Otherwise, an import license must be obtained before the necessary foreign exchange is made available.

A joint venture or subsidiary can sell all or part of its product in Hungary for forints, and the foreign partner's share of the net profit can be transferred into hard currency (the currency of original investment) and freely repatriated. The company's only obligation is to show a positive year-end balance sheet and to obtain a certificate from its bank certifying that it has sufficient forints on deposit to cover the amount to be repatriated. It is assumed that repatriation can occur only at year-end, when the company declares its net profits for the year, although the law is vague on this point.

Poland

The legal environment in Poland was not attractive to foreign investment prior to 1989. There were limitations on the industries in which foreigners could invest as well as on the percentage of the firm they could own. The situation changed in 1989, and Poland is now committed to attracting foreign capital. The Law on Economic Activity with the Participation of Foreigners, approved in December 1988 and amended in December 1989, is one of the most liberal in Eastern Europe.

Under that law, foreign enterprises and joint ventures enjoy more favorable taxation and operating conditions than do Polish enterprises. Nevertheless, impediments to foreign investment remain.

Start-up

A foreign business must obtain a permit from the Foreign Investment Agency (FIA), either in Warsaw or through one of the agency's provincial offices. A draft of the company's founding act and a feasibility study showing that the business will be profitable must be provided. The FIA must make its decision within two months of the company's filing its application.

Once a company has received permission to operate, it must be registered in court as a corporate entity. Delays at this stage apparently are not uncommon, especially in Warsaw's overburdened court system. Only after registration can a company hire workers, rent office space and begin normal operations.

There are no restrictions on the sectors (agriculture, manufacturing, services and trade) in which foreigners can invest. Foreign individuals and institutions (companies, banks, foundations) can establish wholly owned limited liability or joint stock companies with Polish or other partners. Joint stock companies may raise equity through public subscription of shares after securing permission from the Foreign Investment Agency.

Foreigners may also purchase stock in existing Polish limited liability or joint stock companies. The foreign share must be at least 20 percent of the total interest and not less than $50,000.

Foreign businesses can open representative offices to promote or service their products. However, branch offices and technical information offices are subject to separate operational and taxation conditions.

Policy Incentives and Disincentives

As of mid-1989, 13 duty-free zones had been established. Companies operating in these zones are allowed to take goods into or out of them without obtaining or paying customs duty.

Foreign businesses are exempted from paying income taxes during the first three years of operations. The tax holiday may be extended to six years for investments in designated priority areas such as housing construction. A 30 percent rate is normally applied to repatriated dividends unless reduced by a double taxation agreement.

A foreign business must obtain office space on the basis of a rental agreement or long-term lease because current Polish law prohibits foreigners from owning property. If the foreign share of the investment is less than 50 percent of the total, land or property can be purchased in the Polish partner's name. There is a an acute shortage of both residential housing and office space in Poland.

Foreign businesses and joint ventures can hire an unlimited number of Polish workers. However, permission must be obtained from the local authorities to hire foreign labor. Foreign employees must be paid in zlotys, but may apply for a foreign exchange permit to convert their wages to foreign exchange to take out of Poland.

Foreign businesses operating in Poland must maintain local currency bank accounts.

The Business Environment

Foreign businesses in Poland are subject to a corporate income tax (40 percent of the firm's income), turnover tax, and various local taxes and fees. The turnover tax will be replaced with a value-added tax in the next few years. Dividends repatriated abroad are subject to a 30 percent tax, unless reduced in a double taxation agreement.

The Polish telephone system is inefficient. Calls to countries to which Poland does not have direct outbound dialing — including the United States — must be reserved with the international operator hours ahead of time. Connections within Poland are also poor. New users have to wait about 14 years to be connected.

The banking system is inadequate. For example, checks may take up to a month or longer to clear. There is a lack of accounting firms and accounting standards.

While private and foreign-owned companies have access to supplies equal to that of state-owned enterprises, existing relationships may place the former at a competitive disadvantage.

A U.S.-Polish Business and Economic Treaty signed March 21, 1990, provides guarantees to U.S. investors in such areas as expropriation (it will only be permitted for a public purpose and must include prompt payment at a fair market value), dispute settlement (an investor has the right to international arbitration after six months for any type of dispute), and intellectual property protection. A Polish deputy president will serve as ombudsman for U.S. investors experiencing difficulties with registration,licensing, nondiscriminatory access to utilities, regulatory and other matters.

Foreign Exchange

On January 1, 1990, the government of Poland made the zloty partially convertible (internal convertibility). Persons and businesses resident in Poland have the right to purchase foreign exchange to pay for imports, services or other commercial transactions. These transactions must be done at one of the designated foreign exchange banks, and the National Bank of Poland is obligated to provide sufficient amounts of hard currency for this purpose.

The transfer of foreign exchange for profit remittances is restricted, and a foreign exchange permit is required (100 percent of after-tax hard currency surpluses of export revenues over import expenditures may be repatriated; there is a 15 percent limit on repatriation of zloty profits). All foreign exchange earnings must be converted into zlotys.

Individuals can buy and sell hard currency at licensed private exchange bureaus. Rates are determined by supply and demand. Businesses are not permitted to use these bureaus.

Romania

Foreign investment in Romania has been constrained, despite existing legislation to promote East-West trade and to develop the national economy. The joint venture law, enacted in 1972, encouraged trade but did not permit foreigners to own a majority in the venture. The dependency of joint ventures on the expectations of the Romanian National Economic Plan was a further impediment.

Since the December 1989 uprising, the ruling National Salvation Front and the government have generally been unable to secure support to implement contemplated reforms. Without major systemic changes, it is doubtful whether there will be much foreign investment.

Start-up

Romanian government consent is not required if foreign ownership is less than 50 percent. Consent from the Romanian Office for the Promotion of Foreign Investment and the relevant ministries is required if foreign ownership is greater than 50 percent. Decisions are usually rendered within a few weeks of the filing of the application with the government.

Foreign capital may be invested in all sectors of the economy except armaments, explosives, narcotics and drugs.

Policy Incentives and Disincentives

Hard currency profits are exempted from taxation for two years. The Finance Ministry can approve a 50 percent reduction for the following three years. The tax is also reduced by 50 percent for reinvestment in the same company or any other company with Romanian participation.

Foreigners that participate in joint ventures may lease real estate.

Individual factories can sell their products directly on foreign markets.

A bilateral trade agreement with the United States guarantees full compensation for all investments in the event of nationalization or equivalent actions. Domestic legislation also provides the same guarantees for foreign companies investing in Romania.

The Business Environment

Local currency profits are normally subject to a 30 percent tax rate. Profits transferred out of the country are subject to a 10 percent tax rate.

There are three major unions in Romania. The amount of union activity varies, depending on industry and geographic location. Most factories have switched from a six-day to a five- or a five-and-a-half-day work week since the December 1989 revolution. This cutback has caused some production delays.

Foreign Exchange

All citizens and foreigners can now conduct hard currency transactions.

Profit remittances are limited to the amounts in the company's foreign currency account resulting from foreign contributions, earnings and borrowings. There is a limit equal to eight percent of the foreign capital contribution if the funds in the foreign currency account are not adequate to cover profit remittances.

Yugoslavia

In recent years the investment climate in Yugoslavia deteriorated and foreign investment, discouraged by such factors as political instability, runaway inflation and chronic foreign exchange shortages, virtually ceased. Legislation was enacted in 1989 and 1990 to stabilize and transform the economy, and significant progress was made. However, the political situation worsened, and the country's unity is increasingly being questioned, as a result of domestic developments.

On December 22, 1990, for example, the Croatian parliament adopted a new constitution that stated, "Croatia remains a part of Yugoslavia until a new agreement among the republics, or until the Croat parliament decides otherwise." In a referendum the following day in Slovenia, 94 percent of the voters turned out, and 89 percent of them voted for a sovereign and independent Slovenia, either within a Yugoslav confederation or, if that could not be achieved in six months, on its own.

The growing uncertainty about the future of the country is discouraging private capital inflows, as major multinationals are apparently taking a wait-and-see attitude.

Start-up

Foreign investors must submit an application to the Secretariat for Foreign Economic Relations within 30 days of signing the joint venture contracts with the domestic partner. If the application is not denied within 45 days, it can be considered approved.

Foreign joint venture owners can own up to 100 percent of the enterprise, except in banking, where the ceiling is 99 percent.

Policy Incentives and Disincentives

Technically, foreigners can not own property in Yugoslavia. Furthermore, foreign investment is not permitted in rail and air transport, communications media and publishing. Foreign investment in insurance is permitted, but only under special regulations.

Joint venture banks can perform all the functions permitted other Yugoslav banks. All firms, public and private, may now engage in foreign trade, regardless of size. (The special status of Yugoslav trading companies that were originally granted licenses for international trade has effectively been eliminated).

Patents are now extended to 20 years. The mandatory use of Yugoslav trademarks in conjunction with a foreign trademark has been eliminated. Product (in addition to process) protection is now available for certain chemical compounds and pharmaceuticals.

The Business Environment

There are 8,000 taxing entities in Yugoslavia, and there is no uniformity throughout the country. The proliferation of republic laws makes it difficult for foreign investors to estimate the impact of tax rates on planned business investments. The federal corporate income tax is set at 10 percent, although in practice the republics have refused to collect the tax. Republic income taxes range from 14 percent to 35 percent. There are no legislated tax reductions.

Enterprises must pay all social security, health and retirement plan contributions for domestic employees. There are no special provisions for foreign employees.

Foreign Exchange

The dinar was made convertible on January 1, 1990, for current transactions and pegged to the Deutsche Mark at 7:1. Deteriorating economic conditions led the government to suspend convertibility in December 1990 and to devalue the dinar nearly 30 percent on January 1, 1991. Repatriation of profits and invested capital by foreign investors is guaranteed so long as there is sufficient foreign exchange available. There is no requirement to sell foreign exchange earnings to the National Bank of Yugoslavia.

Annex 3

Souhern a Záěr

Vývoj ve východní Evropě předešel v posledních dvou letech v mnoha ohledech všechna očekávání. Potě co Sovětský Svaz připustil aby lidově opozice v Polsku a Východním Německu zesílily a konečně svrhly pevně usazeně režimy, byly v celé oblasti zahájeny rychlé a rozhodné kroky k nastolení demokracie. Politické podmínky se samozřejmě změnily ve všech šesti zemích jmenovaných v této zprávě: Bulharsku, České a Slovenské Federativní Republice, Madàrsku, Polsku, Rumunsku a Jugoslávii. Během tohoto procesu většina těchto zemí položila základy k historické změně z centrálně plánovaného k tržnímu hospodářství.

Velké rozdíly vsak nastaly ohledně tempa ekonomické transformace. Polsko učinilo největší kroky, přijalo široký program mikro- a makroekonomické reformy v krátkém období a výsledky listopadových polských presidentských voleb v roce 1990 ukazuji, že tento vývoj bude zachovan. Podstatný, ale pozvolnejãší pokrok nastal v Madàrsku, které spělo k tržnímu hospodářství již po mnoho let. Také v Jugoslávii byly zavedeny významné ekonomické reformy. Po pozvolném začátku CSFR nastolila velmi silný program. Zato Bulharsko a Rumunsko doposud pouze přijaly makroekonomické programy změn, ale ještě mnoho usilí je třeba vyanaložit na propracování strukturálních reforem a poćeti její uzkutečnóvaní.

Prvni fáze ekonomické reformy, což je zrušení centrálně plánovaného hospodářství a zavázání se k ekonomickému řizení zalozenému na trzní bazi – je vlastne dokončena. Zákony byly navrženy nebo prijaty a byla prijata nekterá důlezitá institucionální usporádání. Nyní přichází druhá fáze – a sice zkous ka síly politického uvědomění -jak se budou nové předpisy rozvíjet a provádet.

Tato zpráva se prevážně zabývá výhledem jak uspokojit potřeby externího financování těchto šesti zemí v příštích několika letech. Protože možnost a užitečnost externího financování je úzce vázána s rychlostí, se kterou budou tyto země rekonstruovat své zastaralé institucionální uspořádání a budovat potřebné nové. Zpráva také rozebírá pokrok a vyhlídky domácích reforem.

Domácí Stabilizace a Adaptace

Vlády států v této oblasi kontrolují téměř vsechny rozhodující problémy hospodářské politiky, které se soustředùjí na otázku jak spojovat účinnou stabilizaci se širokou restrukturalizací. Všechny vlády nyní uznávají potřebu přiměřené fiskální a měnové politiky, za účelem stabilizace jejich ekonomik při rozvijení a zavádění systémových reforem. Hyperinflace v Polsku byla potlačena a v Jugoslavii byla snížena, zatím co madarský vysoký deficit bežného účtu byl preměnen v prebytek a rozpočtový deficit byl odstranen. Všechny tyto země, ačkoliv různou rychlostí, rozvíjejí potřebný právní rámec a podnikatelská pravidla, které vytvářejí a chrání soukromá vlastnická pravá. Vsečh šest zemí také přijímá účetnické metody a jiné podnikatelské praxe průmyslových zemí. Tato opatření v průběhu času zlepší kvalitu economické informovanosti, která je k dispozici podnikům a obyvatelstvu a velice posílí efektivnost ekonomického rozhodování.

Všechny vlády učinily první kroky k utvoření moderního bankovního systému – rozdělujícího funkce centrální banky a obchodních bank. Cíl je jasný: vytvořit systém který může mobilizovat domácí úspory, poskytovat uvery za tržních podmínek a sloužit jako účinný platební systém. Vlády v této oblasti začaly také rozvíjet domácí kapitálové trhy. Privatizační programy byly navrženy, v Polsku a v Madarsku už začaly být dokonce realizovány a probíhá deregulace cen a urokových sazeb. Opatření na ochranu nově nezaměstnaných byla navrzena nebo zesílena. Byl liberalizován mezinárodní obchod a rozšiřena směnitelnost. Samozřejmě je ještě třeba mnoho učinit k dosáhnutí masivní ekonomické reorganisace.

Rychlé Provedení

Vzájemné propojení těchto reforem zdůrazňuje nutnost jejich rychlého provedení. Ukázálo se nemoźným provést tyto reformy součastně a komplexně, dokonce i v těch zemích, které se rozhodly postupovat velice rychle. Časové řízení jednotlivých kroků je však potencionálně tak problematické, že by bylo možná nějlepsím řesením postupovat co nejrychleji pokud mozno na nekolika frontách. Podívejme se například na spojení mezi reformou finančního sektoru, měnovou a úvěrovou politiku, deregulací a privatizací:

- Kontrola rozširování domácího úvěru a omezovaní inflacních tlaků spojených s cenovou deregulací by byla těźká bez reforem finančního sektoru.

- Posuzování hodnoty activ, které mají být privatizovány, by bylo bez liberalizace cen a obchodu těžké a kanály mobilizace úspor soukromého sektoru k nakupování státních podniků by byly bez reformovaného finančního sektoru omezené.
- Ale reformy bez privatizace ve finančním sektoru mohou pokračovat jen do určite míry.

Ačkoliv jsou tyto vzájemně spjaté podmínky komplexní a tězko se k nim přistupuje, neměly by byt používány jako výmluva pro zpomale procesu transformace.

Základní Změny

Uspěšná transformace bude vyžadovat zásadní změny ve znalostech, schopnostech a postojích jak u veřejných činitelů tak i soukromných občanů. Pro vlády v této oblasti liberalizace a reforma znamená vzdát se řízení. Vládní činitelé musí ustoupit od nařizování – předpisování dovolených a zákazu nepřípustných ekonomických činností a ponechat obyvatelstvu a podnikům volnost aby podnikaly, spolupracovaly a soutěžily bez přímého dozoru. Novým podnikům musí být dovoleno, aby se rozvíjely a jakkoliv je to těžké, starým podnikům musí být dovoleno zaniknout. Jestliže podniky, které jsou nyní ve veřejném sektoru, nejsou hospodářsky schopné, mělo by jim být dovoleno bankrotovat.

S růstem nepřímé economické kontroly roste její obtíznost a tudíž kvalita státních úředníků vykonávajících hospodářské vládní funkce by měla být zlepšena dokonce i když počet státních úředníků bude redukován – což je pro veřejnou administrativu krajně těžký ukol.

Zároven pracující stejně tak jako vlastníci a manažeři v soukromém sektoru musí být připraveni prevzít iniciativu, nez čekat na instrukce a pracovat pro dobro svých podniků když se naskytne příležitost. Tito jednotlivci se musí pustit do nekonečné snahy o získání a vyhovění zákazníkům což je základní proces soukromého podnikání. Odměny plynoucí z tohoto procesu – zisk, bohatství a nadprůměrný příjem musí být tolerovány ne-li aktivně podporovány. Na zisk a spekulaci by se nemělo nahlížet s předsudkem a na nerovnost příjmů by se mělo přihlížet jako na nezbytnou součást třzního hospodářství.

Vlády nemohou, a neměly by, vyjma přijetí těchto zmen v postojích, mnoho učinit pro jejich urychlení. Ůpadek komunismu má svůj pramen v mnoha ohledech v neuspěšnych vládních pokusech o zavedení zmeny víry jednotlivce. Opakovat chyby minulosti ve jménu kapitalismu by bylo katastrofální.

Realistická Očekávání

Je třeba se chránit proti nerealistickému očekávání okamžitých zlepšení v ekonomické sféře. Je velice těžké si představit životní uroven východní Evropy rostoucí na uroven okolních prumyslových zemi v přístích pěti nebo dokonce deseti letech, ačkoliv se může stát, zě v polovině desetiletí tempa růstu v některých zemich této oblasti přesáhnou průměrná tempa růstu v průmyslových zemích. Spolu s přerozdělením příjmů které bude nezbytně doprovázet strukturální adaptaci, pomalý růst může způsobit ze se mnoho lidí v této oblasti po určitý čas nedočká zádoucích odměn.

Specifická Opatření

Vedle těchto obecných opatření se musi provést mnoho specifických kroků, jestliže má reforma dospět do stadia kdy podstatně vzroste příliv soukromého kapitálu. Mezi kroky diskutovanými v hlavní části této zprávy musí byt objasněny následující:

- Hlavními prioritami ve finančním sektoru jsou deregulace úrokových sazeb a nutnost zrušení přidělování uvěru státem. Nově vytvořené obchodní banky se musí stát nezávislými organizacemi se silnými rozvahami a se schopností jednat jako efektivní zprostředkovatelé mezi úsporami a investicemi, jako dodavatelé úvěru za tržní ceny pro důvěryhodné věřitele, a fungovat jako efektivní součást platebního systému. Jiní finanční zprostredkovatelé jsou také potřební, ale v tomto stádiu má přednost vývoj zdravěho a spolehlivěho systěmu obchodních bank.
- Zajištění přístupu zahraničních bank k východoevropským domácím trhům by pomohlo k dosazení takového systému. Vzájemné dohody takového typu jako byly připravené Mezinárodní Finanční Korporací (IFC) mezi polskými bankami a zahraničními soukromými obchodními bankami, by byly také žádoucí. Soustředěné úsilí je třeba k zacvičování bankovního personálu aby mohl posoudit půjčky pro projekty, zhodnotit solvencí věřitelů a vykonávat takové úkoly jako běžné finanční analýzy. Je žádoucí aby pokračovala bilaterální a multilaterální technická pomoc pro centrální banky v této oblasti, aby byla poskytnuta pomoc při navrhování a zavádění systému bankovního dozoru. Zároveň by měl být podporován rozvoj

domácích kcapitálových trhů jak pro obligace tak pro akcie. Ačkoliv tyto trhy nemusí být velké, nebo technologicky vyspělé přesto způsob jak jednat na kapitálových trzích a jak s nimi nakládat by mel být pěstován.

- Privatizace potřebuje rychle pokračovat. Vedle zjevné příležitosti kterou představuje prodej státního majetku pro příliv zahraničního kapitálu, přeměna z verejného vlastnictví na soukrome zajistuje, ze domácí podnikatelské prostředí bude příznivé pro zahraniční kapitál. Uspěšny privatizační program dosáhne dvou věcí: založení ziskových samostatných podniků a zánik podniků které nejsou životaschopné. Ačkoliv maximalizace příjmů do veřejné pokladny a rozdělování vlastnictvi jsou politicky důležitý cíl, nejdůležitějším výsledkem racionalizace vlastnictvi průmyslu a jeho vedení a struktůry, je budování životaschopných podniků.
- Tvorba a rozvoj soukromého podnikání musí být také podporován mimo privatizační proces. Pokud jsou potrebné licence by měly být vystaveny co nejrychleji. Veřejna politika musí podporovat vznikající soukromé podniky tím že budou rovnoměrně umožňovat přístup k veřejnému majetku a službám, a všechno usilí musí být vynalozeno na to aby se tato politika spravedlivě vykonávala.
- Pokrok směrem k otevřenosti musí pokračovat pokud jde o liberalizaci obchodu a směnitelnosti. Jasným cílem je plná směnitelnost; jednotný směnný kurs, jednotné a relativně nízké tarify s neomezeným přílivem zboží, služeb a valut. Základním požadavkem pro plné zapojení do mezinárodního hospodářského systému je vytvoření stabilního a otevřeneho

cenového režimu, a kompetitivního směnového kurzu a otevřených kapitálových trhů.

- Vzhledem ke krátkodobému přerušení obchodu, vlády celé oblasti by měly uvažovat o návrhu jak rozvinout zajištující mechanismus pro místní agentůry posilující uvěrové záruky na vývoz s podporou průmyslových zemí. Toto může být zařízeno s pomocí jedné z multilaterálních agentůrý; a tuto iniciativu by mohly podporovat všechny země v této oblasti společně, aby si vzájemně pomáhaly s financováním obchodu do té doby, než se jejich vlastní agentůry na poskytování uvěrových záruk pro vývoz zavedou na mezinarodních kapitalových trzích.
- Je potřebí posílit snahu o zlepšení kvality ekonomických informací dostupných soukrcmému sektoru. Nejenže musí být rychle zavedeny standardy účetnictví a výkaznictví průmyslových zemí, ale také je potřeba masivní technicka pomoc na praktické urovni s cílem vyškolení manažerů, investorů a státních uředníků pokud jde o odchylky a význam učetnických method.

Přesto že behem tohoto procesu příjdou nevyhnutelné překážky směr a hybná síla reformy musí být udržována od počátečního politického rozhodnutí, prés zákonodárství až k realizaci hospodářské politiky. Pokračování oficiálního financování bude záviset na dalším pokroku. Soukromé financování se stane důležitým jediné tehdy, když se základní reformy stanou nezvratitelnými a když bude existovat solidní politický koncensus o tom, ze základní směr reformy by mel být zachován.

Dříve než posoudíme závěry studie týkající se charakteru a rozsahu poytřeby zahraničního financování, je třeba si všimnout jedné skutecnosti týkající se přístupu průmyslových zemí k celé oblasti. Jakkoliv může být zvýšení prístupu podniků z východní Evropy na zemědelské, průmyslové a spotřební trhy v průmyslových zemích obtízné, průmyslové země musí vynalozit na této frontě hlavní usilí. Nemělo by význam podporovat tržní ekonomický systém a součastné zadržet základní formu pomoci potřebnou pro transformaci. Ve světovém měřítku zásadní význam bude mít uśpěch součastných mezinárodních jednání v rámci Uruguajského kola. V regionální úrovni bude břemeno zvýšené otevřenosti spocívat hlavně na Evropském Společenství.

Financování preměny

Má-li široký program reforem pokračovat a mají-li se ekonomiky v oblasti dostat na trajektorii stálého růstu co nejrychleji, bude zapotřebí podstatného prílivu financí.

Podmínky se ve východní Evropě tak dramaticky změnily a změna pokračuje tak rychle, ze předpovědi finančních potřeb a zdrojů při nejlepším pouze ilustrují co se *může* přihodit. V důsledku recese v anglosaských zemích a tlaku způsobeného sjednocením Německa se podmínky v průmyslových zemích také změnily. Přesto je Studijní Skupina toho názoru, že je užitecné se snažit vyhodnotit problémy zahraničního financování, jimž země v oblasti čelí.

K finančním potřebam oblasti přispivají čtyři faktory. Za prvé, Polsko vyžaduje financování na splácení dřívějších dluhů přesto že oficielní věřitelé poskytli částečnou úlevu. Âckoliv v následujících dvou nebo třech letech země bude pravděpodobně vykazovat přebytek na svých zahraničních transakcích před zahájením splácení dluhu, podstatné financování bude třeba pro zbyvající dluhové závazky.

Za druhé pro každou zemi v oblasti se ostře zhoršila platební bilance jako výsledek změn směnných relací se Sovětským Svazem. Za dřívějšího uspořádání převoditelného rublu v rámci Rady Vzájemne Hospodářské Pomoci /RVHP/ byla cena ropy kolem 7 dolarů za barel, přepočítáno v realistickem výměnném kursu. Při novem uspořádání platnem od ledna 1991 stoupla průměrná cena na úrověn světových cen a musí být placena v převoditelne měně. A navíc se předpokládá, že hodnota jednotky vývozuz východní Evropy do Sovětského Svazu klesne jako přímý výsledek konkurence se zbožím z průmyslových zemí.

Za třetí, uskutečnění transformace samo o sobě vyžaduje zdroje. Bez ohledu na schopnost mobilizovat domácí zdroje tyto ekonomiky budou pravděpodobně potřebovat zahraniční financování dovozu. Jestliže se urychlí uvolnění dovozu — což pomůže zajistit úspěch vznikajícímu soukromému sektoru — růst dovozu pravděpodobně podstatně překročí růst hrubého národního produktu (HNP) i za předpokladu omezení dovozu spotřebního zboží.

Konečně nejistota krátkodobého hospodářského výhledu průmyslových zemí a ještě závaznější, zhroucení Sovétského hospodářství znamená, že vývozní možností budou menší, než by jinak mohly být. Množství a hodnota vývozu se bude bezpochyby zvyšovat, ale ne tak rychle jak by se mohlo předpokládat.

Možné scénáře

Důsledky těchto i jiných činitelů jež ovlivní budoucí zahraniční financování jsou v této studii zkoumány v základním kvantitativním scénáři. Podle tohoto scénáre se HNP zmenší během 1991 a 1992 a vzroste ve většině zemí v oblasti během 1993. Roční přírusted v roce 1995 bude kolem tří procent za předpokladu, že se nevyskytnou další vnější nepříznivé šoky a že se udrží tempo ekonomické reformy.

Tento ne příliš vábný výhled vytváří u potencionálních investorů v oblasti vážné obavy o udržitelnosti reforem: budou rožsířené a přetrvávající hospodářské potíze podkopávat veřejný souhlas s reformním procesem?

Ekonomické reformy by měly být urychleny aby se zmenšilo toto risiko. V zemích které tak ještě neučinily jsou všechny důvody k tomu aby se úplně liberalizoval obchod, utvořila otevřená pravidla a postupy pro zahraniční investice, a rychle se rozhodlo o směnitelnosti měny s jediným realistickým směnným kursem. Okamžité kroky které posílí finanční sektor zahrnují uplné uvolnění urokových měr, připuštění zahraniční konkurence, a posílení rozvah nově utvorených bank. Obtížnější ale stejně naléhající kroky zahrnují posilování privatizace a zavírání neschopných podniků, které fungují v ekonomické oblasti jako brzdy. Přesto že mohou ve velmi krátkém období ve skutečnosti zvývšit chybné alokace a potíže, tyto opatření přispějí rychleji kě zlepsení ekonomické efektivnosti a zlepší mobilizaci a alokaci domácích zdroju, čimž přiblíží okamžik, kdy dojde k obnovení hospodářského růstu.

Za účelem prozkoumání možného rámce zvýšení tempa reforem zahrnuje tato studie druhý kvantitativní scenář. Přesto, že by urychlená reforma zvýšila nároky na financování, mela by soucastně posílit schopnost absorbovat zvýšené zahraniční financování, posílit zahraniční oficielní podporu a přilákat vetší přiliv financí že soukromého sektoru. Vzhledem k těmto dop[rovodným účinkům pravděpodobné přínosy — vyjádřené rychlejším růstem a zvýšeným zahraničním financováním — mohou být velmi žávazné. Pokud by bylo tempo reforem urychleno, alternativní sčenář naznačuje, že by se růst HNP mohl silne oživit v roce 1993 a ze v roce 1995 by průmerné tempo růstu v oblasti překročilo pet procent.

Potřeby zahraničního financování v základním scénáři rostou ze 36 bilionů dolarů v roce 1991 na 52 bilionů dolarů v roce 1995. Přesto že se běžná platební bilance oblasti jako celku zlepší z deficitu asi 12 bilionů dolarů na deficit asi 8 bilionů dolarů, splátky středně- a dlouhodobých úvěrů (před snížením dluhu) se zvýší z 10 bilionů dolarů na asi 17 bilionů dolarů. A s rozvojem obchodu s průmyslovými zeměmi se zvojnásobí splátky krátkodobých úvěrů na asi 28 bilionů dolarů.

Dostupnost financování

Tento objem financovani se zdá naprosto schůdný. Odezva soukromých i verejných finančních zdrojů byla během minulých dvou let povzbudivá. Program reforem v oblasti jasně upoutal naděje a dobrou vůli průmyslových zemí. To by se ovšem nemělo vykládat tak, ze vlády i soukrome podniky průmyslových zemí plánuji pro blízkou budoucnost příliv velkého rozsahu financování do východní Evropy. Zvláště relativně velké závazky přílivu kapitálu do bývalé Nemecké Demokratické Republiky z Nemecké Spolkové Republiky a jiných průmyslových zemí by nemely být posuzovańy jako příklad. Krátkodobě, ve skutecnosti rozsah použitelné pomoci — a její pravděpodobná dostupnost — je zastínena rozsahem systémové trensformace jíž oblast prochází.

Krátkodobý výhled pro příliv soukromého kapitálu se zdá omezený, dokonce za nejlepších okolností. Určitý příliv kapitálu byl usměrněn do Východního Německa díky relativne příznivým příležitostem které nabízí — a byrokratickým překážkam pro investice přetrvávajícím jinde ve vychodni Evropě — jež platí stejně pro způsob jakým jsou změny uskutečňovány a rovněž pro jejich formulování. Určité slibné investice se neuskutečnily bud pro nerealistické požadavky vlád, nebo pro nejistoty týkající se podmínek transakcí – či dokonce kvůli smluvním stranám. Krátce, obchodní vyjednávání je velice těžké.

V každém případě se zdá že velmi málo obchodních přílezitostí je tak výhodných , aby vyvážily těžkosti a rizika s tím spojená. Jazykové překážky, nedokonalá infrastruktura a problémy zivotního prostředí budou zabranovat přilivu kapitálu do východní Evropy. Přetrvávají nejistoty s ohledem na vlastnictví a kontrolu aktiv a práv zahraničních investorů v případě sporu. Určení hodnoty aktiv je obtižné protože chybí jejich historické učetní doklady, tak i předchozí určení ceny na základě trhu, podle kterého by bylo možno ohodnotit hospodářské výsledky podniků.

Půjčky zahraničních bank místním podnikům – soukromým i státním se státní garancí ci bez ní – vzrostou podle základního scénáře během příštích peti let pouze mírně. Uvolnováí středních a dlouhodobých uvěrů obchodními bankami průmyslových zemí roste z 2 bilionů dolarů v roce 1991 na 5 bilionů dolarů v roce 1995.

Většinu uvěru mohou poskytovat evropské banky ve forme financování vývozu nebo ve forme společného financování s oficiálními agentůrami. Jednotlive podniky a vlády v oblasti si mohou vypůjčovat prímo na kapitálových trzích průmyslových zemí ale – navzdory nedávným příkladům – výsledný příliv kapitálu bude pravděpodobně omezen. Přime investice do oblastnich podniků a do rodících se domácích kapitálových trhů by měly pomalu růst že skoro neexistujícího základu. Přesto že několik přímých zahraničních investic bylo ohlášeno, některé již započaly a více jich bude bezpochyby realizováno, očekává se, že se příslusný příliv kapitálu uskuteční postupné během několika příštích let.

Celkové uivolnování středních á dlouhodobých uvěru z oficiálních a soukromých zdrojů vzroste v základním scenáři z asi 13 bilionů dolarů na 18 bilionů dolarů pro celou oblast mezi lety 1991 a 1995. A navíc přiliv vlastniho kapitálu vzroste z asi 1 bilionů dolarů v roce 1991 na asi 2,5 bilionů dolarů v roce 1995, a hodnota nových akcií a přímých investic dosáhne během příštích peti let 10 bilionů dolarů.

Zrychlení reforem by melo být spojeno s rychlejším růstem a akumulací zahraničního financování. Z pocátku by mely být zvýšené pozadavky uspokojeny z oficiálních zdrojů financování.

Ve scénáři urychlené reformy je uvolňování oficiálních středně- a dlouhodobých finančních prostředků v roce 1993 a dále v roce 1994, vyšší o 15 procent než v základním scénári. Je třeba zdůraznit, že vzhledem k období které je potřebné k záhajení programu pomoci, nárůst uvolňování v roce 1993 v tomto rozsahu je založen za predpokladu že reforma bude uspísena velmi brzy. Zvýšení uvolnování potom dosáhne o 5 procent vyššich hodnot než bylo uvažováno pro rok 1995 v základním scénáři, když by reformy mely dostatěcne postoupit aby vyvolaly podstatné zvýšení přílivu soukromého kapitálu jak ve formě uvěru, tak ve formé investic.

Ve scenáři zrychlené reformy soukromé půjčky vzrostou ze 3 bilionů dolarů v roce 1993 na 7 bilionů dolarů v roce 1995 a zahraniční přímé investice vzrostou z 2 bilionů dolarů v roce 1993 na víc než 7 bilionů dolarů v roce 1995. V tomto druhém scénáři souhrn soukromých investic a zahraničních přímých investic dosáhne v období pěti let od roku 1991 do roku 1995 více než 15 bilionů dolarů.

Tyto soukromé investice se mohou zdát málé v porovnáni s celkovými potřebami kapitálu v oblasti. Na základě současných hrubých odhadů, privatizační programy v každém ze států se zdají více nez schopné absorbovat tyto částky samy o sobé. Ale tyto odhady hodnot státních aktiv úrcených pro privatizaci mohou být revidovány dolů.

Samozřejmě průběh privatizace by nemel být zpomalen pokusem o uskutečnění prodeje státního majetku za předem zamýšlené ceny. Lepší způsob by byl zdvojnásobit usilí mobilizovat domácí zdroje, coz podtrhuje důlezitost reformování finančního sektoru v oblasti.

Vlády v oblasti by měly zvyšit úsili na získání soukromúho kapitálu a hlavně přímých zahraničních investic bez ohledu na to jak malé jsou v přítomnosti. Jak si tyto vlády dobře uvědomily, cizí společnosti s sebou přinesou technologii, zkušenost vedení a zajištěné vstupy na trhy průmyslových zemí. Ještě důlezitější je, že kroky potřebné na zajištování přímých zahraničních investic jsou shodné s kroky vedoucími k vytvoření kvetoucího domácího soukromého sektoru.

Odpovědnost Průmyslových Zemi

Za prvé, značná část přílivu kapitálu bude muset přijít z oficialních zdrojů. Nejdůlezitějsí je, aby tato vnější pomoc byla dobre navržena a skutečně potrébná. A vyjma humanitární, veškerá ostatní pomoc by měla být poskytována pouze tém zemím ktére vynakládají vážné a stálé úsilí reformovat.

Tato studie naznačila vztah mezi reformou, vnejším přílivem financí a udržitelným ekonomickým růstem. Průmyslové zemé a mezinárodní instituce musí v průbehu diskusí s vládami této oblasti formulovat tento vz tah plněji a měly by být připraveny se zavázat k dalsímu financování, jestliže se reforma zrychlí.

Mělo by se plně využít financování mezinárodních institucí, které mohou získavát finanční zdroje na mezinárodních kapitálových trzích a tímto se vyhnout explicitním rozpočtovým problémům které by se politicky těžko řešily v této době v některých průmyslových zemích. Mezinárodní instituce budou hrát rozhodující úlohu nejenom ve financování sektorálních projektů a strukturálních uprav, ale také v rozširené technické pomoci a rovněž v připravování půdy pro příliv podstatného množství soukromého kapitálu, který je potřeba, má-li tato oblast dosáhnout svůj plný ekonomický potenciál.

Konećně je třeba zdůraznit źe průmyslové země musí udělat vše pro uvolění východevropského vývozu na jejich trhy. Pro zemědělské produkty je to zvlášté důležité. Jako nezbytný důsledek blízkého sousedství největší výhody můze Vychodní Evropa získat z jakékoliv akce jež je schopné učinit Evropské Společenství na tomto poli.

Času Není Nazbyt

Země východní Evropy mají dva či přinejlepsim tři roky na to aby učinily nenávrátne změny v jejich ekonomických systémech. Proces reformy bude nepochybnž trvat déle, jestliže se však většina základních reformních opatření neuskutecní včas, celý proces přeměny by mohl být ohrozěn a mohlo by být zabráněno prílivu zahranicního kapitálu. Jednotlivci, kteří nutně ponesou břemeno nezaměstnanosti a nižší životní urovně během procesu transformace, pravděpodobně pozbydou trpělivosti jestližě nebude žádne zlepšení v dohledu. Bez podpory mohou být opatření k urychlení růstu a přiliv soukroměho kapitálu odkládány donekonečna, a úsilí, plné zapojit země této oblasti do mezinárodního ekonomického systému, by se mohlo zeslabit.

Jsou předpoklady, že proces proběhne úspěšně, jestliže reforma se zrychlí a bude mít dostatečnou vnější podporu. Ačkoliv se průmyslove země neodvážily doufat v politickou přemenu jež nastala ve východní Evropě během posledních dvou let, celý svět bude podstatně těžit z toho když se tato oblast stane prosperující, stabilní a dobře asimilovanou do mezinárodní ekonomiky. Průmyslové zemé maji tudiž silný zájem otevřít svoje trhy a poskytovat štědrou pomoc. Vlády celé oblasti mají eminentni zájem v rychlém pokračování transformace. Vsichni dohromady se musí držet pevné svých představ a závazků a dostát historicke výzvě.

Annex 4

Összegzés és Következtet

Kelet-Európában az elmúlt két évben végbement fejlemények sok vonatkozásban felülmúltak minden várakozást. Miután a Szovjetúnió elnézte a lengyel és a kelet-német ellenzéknek, hogy fokozza tevékenységét és végül megbuktassa a fennálló rendszereket, Kelet-Európa más régióiban is döntő lépések történtek a demokrácia felé. A politikai feltételek minden bizonnyal megváltoztak az e jelentésben említett mind a hat országban: Bulgáriában, a Cseh és Szlovák Köztársaságban, Magyarországon, Lengyelországban, Romániában és Jugoszláviában. E folyamat során a legtöbb fent említett ország megteremtette egy, a központi tervezésből a piacgazdaság felé haladó történelmi átalakulás alapjait.

A gazdasági átalakulás gyorsaságában azonban számottevő különbségek észlelhetők. Lengyelország tette meg a legnagyobb lépést azáltal, hogy viszonylag rövid időn belül a mikro- és a makrogazdaságot egyaránt átfogó programot alkalmazott. Az 1990 novemberi lengyel elnökválasztás eredményei azt sugallják, hogy ez a lendület nem fog csökkenni. Alapvető, habár nem olyan ugrásszerű haladás mutatkozik meg Magyarországon is, ahol a piacgazdaság már sok év óta alakulóban van. Jelentős gazdasági reformok mennek végbe Jugoszláviában is. Egy késői kezdet után a Cseh-Clovák Szövetségi Köztársaság is elindította saját komoly [gazdasái] programát.

Bulgária és Románia azoban csak a közelmúltban hagyták jóvá a makrógazdasági átalakulásról szóló programtervezetet. A szerkezeti reformprogramok kidolgozásához, úgymint azok kivitelezéséhez még sok munkára van szükség.

A gazdasági reform első szakasza – a központi irányítású gazdaság visszautasítása és elkötelezettség a piacalapú gazdaságirányítás mellett – tulajdonképpen lezárult. Új törvényhozási javaslatok születtek és léptek életbe, valamint alapvető átszervezések is történtek intézményi szinten. A második szakasz – a politikai elkötelezettség erőpróbája az új irányítás kialakítása és alkalmazása során – most következik.

Ez a jelentés elsősorban azt próbálja feltérképezni, hogy a hat országnak milyen külső-finanszírozási igényei lesznek az elkövetkezendő néhány év során. A külső finanszírozás azonban feloldhatatlanul összefügg az országokban végbemenő intézményes átalakítás gyorsaságával és mélységével. Ezért a jelentés szintén vizsgálja a belföldi átalakítás előrehaladását és kilátásait.

A belföldi stabilizáció és szabályozás

A térség országainak kormányai szabályozzák mintegy az összes olyan kritikus gazdaságpolitikai kérdést, amely a hatékony stabilizáció és az átfogó szerkezeti szabályozás összekapcsolásával foglalkozik. Mind a hat említett ország kormánya elismeri egy megfelelő költségvetési és pénzügyi politika kialakításának szükségességét a célból, hogy rendszerszerű új formák alakuljanak ki, kerüljenek alkalmazásra és a gazdaság megszilárduljon. A lengyelországi hiperinfláció megszűnt, Jugoszláviáé csökkent és Magyarország hatalmas folyószámla-hiánya a visszájára fordult és költségvetési deicitje megszünt. Habár különböző gyorsasággal, de mindegyik ország az olyan törvényes és üzleti keretek létrehozásán munkálkodik, amelyek a magántulajdonjog megalapítását és védelmét szolgálják. Mindemellett mind a hat ország alkalmazza az ipari országok könyvelési eljárásait és üzleti gyakorlatát. Idővel ezek a lépések javítani fogják a vállalkozások és a háztartások számára hozzáférhető információ minőségét és számottevően jobb lesz a gazdasági döntéshozatal hatékonysága.

Az említett kormányok mindegyike megtette a modern bankrendszer létrehozásához szükséges kezdő lépéseket azáltal, hogy elválasztották a központi bank és a kereskedelmi bankok szerepét egymástól. A cél világos: olyan rendszert létrehozni, amely megmozgatja a belföldi megtakarításokat, piaci hiteleket nyújtani és hatékony fizetési rendszerként funkcionálni. A térség kormányai megkezdték a belföldi tőkepiacok kiépítését is. Privaticációs programokat dolgoztak ki és Lengyelország és Magyarország el is kezdte ezek végrehajtását. Az árak és a kamatok szabályozás alóli feloldása szintén folyamatban van. A munkanélküliek védelmére biztonsági hálókat hoznak létre vagy erősítenek meg. A nemzetközi kereskedelem egyre jobban felszabadul és a valuták átválthatósága egyre szélesebb körűvé válik.

Mindezek mellett még nagyon sok tennivaló van hátra ahhoz, hogy a mélyreható gazdasági újrarendezés megvalósuljon.

Gyors kivitelezés

Ezen reformok kölcsönösen összekapcsolt temészetéből adódik, hogy bevezetésüknek minél előbb meg kell történnie. Egyidejű és átfogó alkalmazásuk lehetetlennek bizonyult még azokban az országokban is, amelyek a gyors átalakítást választották. A különböző területek egymás mögé állítása azonban veszélyeket rejthet magában, ezért célszerűbb több területen előrelépni olyan gyorsan, ahogy csak lehet. Vizsgáljuk meg például a pénzügyi szektor reformja, a monetáris- és hitelpolitika, a szabályzók feloldása valamint a privatizálás közötti kapcsolatot.

- A pénzügyi szektor reformja nélkül két dolog ellenőrzése lenne nehezen végrehajtható: a belföldi hitelnövekedésé valamint az árak felszabadításából következő inflációs nyomásé.
- Az árak és a kereskedelem liberalizálása nélkül a privatizálásra kerülő vagyonok felmérése lenne problematikus, a pénzügyi szektor reformja nélkül viszont azok a csatornák lennének akadályozva, amelyek mozgósítanák a magánszektor megtakarításait az állami vállalatok felvásárlására.
- És mégis, privatizáció nélkül a pénzügyi szektor reformja nem juthat ennél tovább.

Habár ezek az egymásba kapcsolódó feltételek nagyon összetettek, és éppen ezért megfogalmazásuk is nehézkes, nem szabad, hogy felmentő okként szolgáljanak a reformfolyamat esetleges lelassulásához.

Alapvető változások

A sikeres átalakuláshoz alapvetően meg kell változnia a közhivatalnokok és a magánemberek magatartásának, képességeinek és tudásszintjének. A térség kormányai számára a reform és a liberalizáció az ellenőrzés feladását jelenti. Az állami hivatalnokoknak ezentúl nem előírniuk kell a gazdasági tennivalókat, hanem tiltani a megengedhetetlen tevékenységeket annak érdekében, hogy a háztartások és a vállalkozók szabadon tudjanak megújúlni, együttműködni és versenyezni egymással mindenféle közvetlen felügyelet nélkül. Meg kell engedni, hogy új vállalkozások jöjjenk létre és – akármilyen nehéz is lesz – hagyni kell, hogy a nem nyereséges üzletek és vállalatok tönkremenjenek. A jelenleg az állami szektorban működő vállalatoknak meg kell adni azt a lehetőséget, hogy felszámolják magukat, ha gazdaságilag nem ütőképesek. A gazdasági irányítás egyre kifinomultabb és egyre közvetlenebb lesz, ezért a kormány gazdasági kabinetjének a tevékenységét és szolgáltatásának minőségét is javítani kell. Mindezt a személyzeti létszám csökkentése mellett, ami kiváltképp súlyos közigazgatási kihívás.

Ugyanakkor a magánszektor alkalmazottainak, tulajdonosainak és vezetőinek egyaránt fel kell készülniük arra, hogy ha alkalom adódik, kezdeményezőként lépjenek fel a vállalkozásuk előnyét és javát szolgálandó, ahelyett, hogy utasításra várnak. Állandó feladatuk kell hogy legyen a magánvállalkozás központi mozgatórugójának szem előtt tartása, azaz a vásárlóerő fellelése és kielégítése. E tevékenység jutalmát, a profitot, a gazdagságot és az átlagon felüli jövedelmet el kell ismerni, de még inkább aktívan támogatni. A **profit és a spekuláció** létezését nem szabad előítéletekkel fogadni és a jövedelmek közötti különbségeket a piacgazdaság velejárójának kell tekinteni.

A kormányoknak azonban azon túl, hogy elfogadják az ehhez hasonló attitűdbeli változásokat, nem lehet – és nem is szabad – többet tenniük annak érdekében, hogy felgyorsítsák őket. Sok vonatkozásban a kommunizmus bukása az egyéni meggyőződés megváltoztatására irányuló sikertelen állami próbálkozásoknak köszönhető. A múltbeli hibák megismétlése a kapitalizmus égisze alatt azonban végzetes lehet.

Reális elvárások

Nem szabad megengedni, hogy a gazdasági jólét azonnali javulását hirdető, a valóságnak nem megfelelő elvárások felülkerekedjenek a társadalomban. Elég nehéz elképzelni azt, hogy a kelet-európai országok életszinvonala az elkövetkező öt vagy akár tíz évben az ipari országokéval egy szintre emelkedik. Jóllehet a növekedés üteme az évtized közepe előtt a térség egy részében akár túl is szárnyalhatja az ipari országok által elért átlagos növekedési szintet. A lassú növekedés és a jövedelem-újrafelosztással szükségképpen együtt jelentkező szerkezeti módosítás együttesen még egy ideig sok embert megfoszthat a térségben attól, hogy élvezhető nyereségre tegyen szert.

Jellegzetes módosítások

Ezeken a csodaszereken kívül sok sajátos lépés alkalmazására is szükség van ahhoz, hogy az átalakulás olyan mértékig haladjon előre, amely ponttól a magántőke jelenléte jelentősen növekszik. A jelentés fő részében megvitatott lépések közül a következőket kell kiemelni:

- A pénzügyi ágazatban elsőbbséget kell adni a kamatráták felszabadításának és az állam irányításával történő hitelkijelölések megszüntetésének. Az újonnan létrehozott kereskedelmi bankoknak független intézményekké kell válniuk, amelyek erős egyensúlyi mérleggel rendelkeznek, valamint hatékonyan közvetítik a megtakarításokat a beruházások felé. Ezen túlmenően piaci áron nyújtanak hitelt hitelképes kölcsönzőknek és hatékony alkotórészei a fizetési rendszernek. Természetesen más pénzügyi közvetítő szervek kialakulása is szükséges, de a jelen fázisban egy megbízható, szilárd kereskedelmi bankrendszer kell hogy elsőbbséget élvezzen.

- Külföldi bankok közvetlen jelenléte a kelet-európai belföldi piacokon segíthetne egy ilyen rendszer kialakításában. Ikeregyezmények létrehozása kívánatos, mint például a Nemzetközi Pénzügyi Társaság (IFC) által létrehozott egyezmény lengyel bankok és külföldi magánbankok között. Összehangolt erőfeszítésre van szükség; olyan bankszemélyzet képzésére, amely képes hitelfeltételeket elemezni, hitelfelvevők fizetőképességét összegezni és rutinszerű pénzügyi elemzéseket végezni. Kívánatos ezenkívül kétoldalú és sokoldalú technikai segélynyújtás létrehozása a térség központi bankjai számára az ellenőrzési rendszer megtervezésében és alkalmazásában. Ezzel egyidejüleg a belföldi tőkepiacok kifejlesztése úgy kötvényekre mint részvényekre szintén bátorítandó. Ezeknek nem szükséges nagy volumenű, technikailag kifinomult piacoknak lenniük, de az, hogy hozzáférhetők és tőkepiacok legyenek, nem elhanyagolandó.

- A privatizációnak gyorsan kell végbemennie. Amellett a nyílvánvaló lehetőség mellett, hogy az állami tulajdonok eladása fellendíti a külföldi tőkebeáramlást, az állami tulajdonról a magántulajdonra való váltás elősegíti azt is, hogy a belföldi vállalkozói környezet nem lesz ellenséges a külföldi tőkével szemben. A sikeres privatizációs program két dolgot valósíthat meg: létrehoz profitképes és független vállalkozásokat és megszünteti azokat, amelyek nem versenyképesek. Politikiailag fontos cél az, hogy a köz számára újra felosztandó bevételek növekedjenek és hogy a magántulajdonosok száma emelkedjen; a versenyképes vállalkozások kifejlesztése azonban a legfontosabb eredménye az ipari szerkezet, az igazgatás és a tulajdon racionalizálásának.

- A magánvállalkozások kialakítását és fejlesztését a privatizáció folyamatán kívül is ösztönözni kell. A vállalkozásokhoz szükséges engedélyek kiadásával nem szabad késlekedni. A közigazgatásnak segítenie kell a születőfélben levő magánvállalkozásokat úgy, hogy esélyegyenlőséget biztosít a szolgáltatások és árucikkek hozzáférhetősége terén. Emellett minden erőfeszítést meg kell tenni annak érdekében, hogy az előírásokat mindenkire nézve egyenlően alkalmazzák. Ami a kereskedelem és a valutagazdálkodás felszabadítását illeti, a nyitottságra való törekvésnek folytatódnia kell. A cél a teljeskörű konvertibilitás, egyetlen árfolyamrendszer, egységes és viszonylag alacsony díjszabás, és szabad árucikk- szolgáltatás- és valutaáramlás kialakítása. A nemzetközi gazdasági rendszerbe való teljes beilleszkedés előfeltételei a stabil és nyitott árrendszer, a versenyképes árfolyamrendszer és a nyitott tőkepiacok létrehozása.
- A térség kormányainak, mivel a kereskedelem rövidlejáratú szétesésével kell szembenézniük, érdemes fontolóra venniük azt a javaslatot, hogy az ipari országok támogatásával fejlesszenek ki egy viszontbiztosítási rendszert a helyi export-hitelgarancia ügynökségek védelmére. Amíg a térség országainak saját export-hitelgarancia ügynökségei létre nem jönnek a nemzetközi tőkepiacokon, addig kezdetként az egymás között folyó kereskedelem finanszírozására létrehoznának egy közös támosgatású multilaterális ügynökséget.
- Erősíteni kell az ösztönzőket a magánszektor számára hozzáférhető gazdasági információ minőségének javítására. Nemcsak az ipari országokéval megegyező színvonalú könyvelési

és számadási rendszert kell bevezetni amint csak lehet, hanem gyakorlati szintű technikai tanácsadás is szükséges a vezetők, beruházók és közalkalmazottak számára a részletes könyvelés módszertanáról és jelentéséről.

Az elkerülhetetlen kudarcok ellenére a reform irányát és lendületét fenn kell tartani a politikai elkötelezettségtől kezdve, a törvényhozáson keresztül az alkalmazásig. A folyamatos hivatalos finanszírozás a folyamatos előrehaladás feltétele lesz. A magánfinanszírozás csak akkor válik számottevővé, amikor az átalakítás már alapjaiban visszafordíthatatlan, és szilárd politikai egyetértés tapasztalható a reform irányának folytatását illetően. Mielőtt megvizsgálnánk a tanulmány következtetéseit a külső finanszírozási szükségletek jellemzőiről és mértékéről, egy megjegyzést kell közbevetnünk az ipari országok politikájára vonatkozóan a térség iránt. Akármilyen nehéz is, de az ipari országoknak számottevő erőfeszítéseket kell tenniük annak érdekében, hogy a kelet-európai országok vállalkozásai számára növeljék a fejlett országok mezőgazdasági, ipari és fogyasztói piacainak hozzáférhetőségét. Nem sok értelme van egyfelől a piac alapú gazdasági rendszert hirdetni, ha másfelől a segítségnyújtás fő útjai el vannak zárva az átalakítás megvalósítása előtt. Globális szinten az Uruguay-i Kör jelenleg folyó sokoldalú tárgyalásai meghatározó érvényűek lesznek. Helyi szinten a növekvő nyitottsággal együttjáró terheket az Európai Közösségnek kell viselnie.

Az átalakítás finanszírozása

Ha a reform átfogó programja folytatódni fog és a térség gazdaságai fenntartható növekedési útra lépnek, az országoknak számottevő tőkebeáramlásra lesz szükségük.

A kelet-európai feltételek olyan drámai gyorsasággal változtak és változnak még ma is, hogy az anyagi szükségletek és források előrevetítése a legjobb esetben is csak illusztrálhatja azt, ami esetlegesen történhet. Az angolszász gazdaságokban végbemenő gazdasági válság és a német újraegyesítés által keletkezett feszültségek eredményeképpen az ipari országok feltételei szintén megváltoztak. Mindezek ellenére azt a nézőpontot valljuk, hogy meg kell kísérelni számbavenni a térség országai előtt álló külső támogatás problémáit. A térség finanszírozási szükségletei négy tényezőből állnak össze. Először: Lengyelországnak finanszírozásra van szüksége, hogy törlessze múltbeli adósságait, annak ellenére, hogy hivatalos hitelezőktől adósságkönnyítésekben részesült. Habár az elkövetkező két-három évben az ország valószínüleg többletet fog elkönyvelni külső tranzakcióiból mielőtt adósságtörlesztését teljesítené az adott évben, számottevő finanszírozásra lesz még szüksége, hogy fennmaradó adósság-kötelezettségeit törlessze.

Másodszor: A térség országainak mindegyikénél erős romlás tapasztalható a fizetési mérlegben, ami a Szovjetúnióval megváltozott kereskedelmi feltételek romlásának számlájára írandó. A KGST régi transzferábilis-rubel elszámolási rendszerében az olaj ára körülbelül hét dollár volt hordónként egy, a valóságnak megfelelő valutaárfolyamon számolva. Az új megegyezések szerint, amelyek 1991. január óta vannak életben, az olaj átlagára világpiaci szintre emelkedik és konvertibilis valutában fizetendő. Ezen túlmenően a Szovjetúnióba irányuló kelet-európai export egységenkénti értéke is valószínű, hogy csökkenni fog, mivel ezentúl az ipari országokból származó árukkal is versenyezniük kell.

Harmadszor: az átalakulás folyamata maga is forrásokat igényel. Akármilyen kapacitású belföldi forrásaik vannak is, az országoknak valószínüleg szükségük lesz külső finanszírozásra importjuk támogatásához. Amennyiben a behozatal liberalizálása megfelelő gyorsasággal folyik – amely tény bizonyítaná, hogy a fejlődésnek indult magánszektor valóban hatékony, akkor az import növekedése valószínüleg meghaladja az össznemzeti termék (GNP) növekedését, még abban az esetben is, ha a fogyasztási cikkek importja nincs ösztönözve. Az exportk mennyisége és értéke, bár nem az előrejelzések. alapján várható sebességgel, de kétséctelenül növekedni fog.

Lehetséges változatok

A fent említett és még más olyan vonatkozású tényezők, amelyek befolyásolni fogják a jövőben a külső finanszírozást, e jelentésben az alapmennyiségi változatban vannak tárgyalva. E változat szerint az össznemzeti jövedelem csökkenni fog 1991-ben és 1992-ben és növekedni a térség legnagyobb részében 1993 folyamán. Az 1995. évi növekedés átlaga elérheti és meghaladhatja a 3 %-ot, feltéve, ha nem lép fel több külső sokkoló, hátráltató tényező és a gazdasági reform iránya fennmarad.

A térség potenciális beruházói számára komoly gondokat jelenthet ez a kevéssé derülátó kilátás a reform fenntarthatóságával kapcsolatban. Vajon alá fogják-e aknázni a reformfolyamat társadalmi befogadását a hosszan tartó és széleskörű gazdasági nehézségek?

Ahhoz, hogy ennek kockázata csökkenjen, a gazdasági átalakítást fel kell gyorsítani. Azoknak az országoknak, amelyek még nem cselekedtek ekként, minden okuk megvan arra, hogy amilyen gyorsan csak lehet, teljesen liberalizálják kereskedelmüket, nyitott szabályokat és folyamatokat hozzanak létre a külföldi beruházók számára, és sürgősen döntsenek valutájuk konvertibilissá tétele mellett, mégpedig egyetlen és reális árfolyanrendszer létrehozásával. A pénzügyi szektor megerősítését szolgáló azonnali lépések közé tartozik a kamatráták teljes felszabadítása, a külföldi verseny megengedése és az újonnan létrehozott bankok egyensúlyi mérlegének erősítése. Sokkal nehezebb, de egyaránt sürgős lépés a privatizáció folyamatának gyorsítása és az életképtelen vállalatok bezárása, mert ezek fékezik a térség gazdaságát. Habár az ilyen és ehhez hasonló lépések rövid távon fokozhatják a nehézségeket, hosszú távon azonban növelik a gazdasági hatékonyságot és javítják a belső források mozgósítását és szétosztását, ezáltal közelebb hozván a napot, mikor a növekedés folytatódik.

A tanulmány egy második mennyiségi változatot is tárgyal, amely azt vizsgálja, hogy milyen módon lehet a reform gyorsaságát növelni. A felgyorsított reformnak növekednének a finanszírozási szükségletei, emellett azonban lökést adna a térség tőkefelvevő kapacitásának, előmozdítaná a külföldről jövő hivatalos támogatást és ösztönzőerőt jelentene a magánszektorból származó tőkebeáramlás számára. Ezen együttes hatások várható nyeresége a gyorsabb növekedést és a nagyobb külföldi tőkebeáramlást tekintve számottevő mértékű lehet. A jelenlegi változat szerint a reform tempójának gyorsítása esetén az össznemzeti termék jelentősen emelkedne 1993-ban, és a térség átlagos évi növekedési rátája az 5%-ot is meghaladhatná 1995-re. Az alapváltozat szerint a külső finanszírozás igénye az 1991-es 36 milliárd dolláros szintről 52 milliárd dollárra ugrana 1995-re. A térség folyószámla mérlege összességében tekintve 12 milliárd dolláros-deficit szintről 8 milliárd dollárra fog javulni. Az amortizáció azonban a közép- és hosszúlejáratú hiteleknek köszönhetően (az adósságcsökkentés előtt) 10 milliárd dollárról mintegy 17 milliárd dollára fog emelkedni. Amellett, hogy az ipari országokkal folytatott kereskedelem növekszik, a rövidlejáratú hitlek amortizációja mintegy 28 milliárd dolláros szintre fog emelkedni.

A finanszírozás elérhetősége

A finanszírozás ilyen szintje tökéletesen megvalósíthatónak látszik. Az elmúlt két év során úgy a magán, mint a társadalmi forrásból származó finanszírozás készsége bátorítónak bizonyult. A térség reformprogramjai egyértelműen megnyerték maguknak az ipari országok figyelmét és jóakaratát. Mindazonáltal ezt nem lenne tanácsos akként értelmezni, hogy az ipari országok kormányai és magánvállalatai nagyobb mértékű tőkebevitelt terveznek Kelet-Európába a közeljövőben. Különösen a volt Német Demokratikus Köztársaságba irányuló és a volt Német Szövetségi Köztársaságból valamint más ipari országokból eredő, viszonylag magas tőkebeáramlást nem szabad viszonyítási alapként értelmezni. Valójában a közeljövőben esedékes hasznos segítség mértéke és valószínű hozzáférhetősége eltörpül a térségben végbemenő átalakítás mértéke mellett.

A magántőke beáramlásának rövidtávú kilátásai még a körülmények legjobb állása esetén is korlátozottak. Németország keleti részében tapasztalható némi tőkebeáramlás az ott található viszonylag kedvező körülményeknek köszönhető, de Kelet-Európa más részében a beruházások előtt álló akadályok még megvannak úgy az eljárásmódban, mint az elvekben. Néhány ígéretes beruházás éppen a valóságnak nem megfelelő kormányzati elvárások miatt bukott meg, vagy a tranzakció feltételei körüli bizonytalanságok vagy akár a résztvevő felek voltak a visszavonulás okai. Röviden, nehéz üzletet kötni.

Mindenesetre szemmel láthatóan kevés alkalom nyereséges annyira, hogy elbírja a lehetséges nehézségek és kockázatok terhét. Nyelvi korlátok, az elmaradott infrastruktúra és környezeti problémák együttesen továbbra is akadályozzák a magántőke beáramlását Kelet-Európába. Még mindig bizonytalanság uralkodik a tulajdonjogi, vagyonellenőrzés-jogi és a külföldi beruházók más jogi vitáit illetően. A vagyonok értékének megállapítása is nehézkes, mivel vagy nincsenek történelmi kimutatások, vagy az előzetes, a piac által meghatározott árak hiányoznak, amelyek alapján a vállalkozások bemenő és kimenő értékét meg lehetne határozni.

A külföldi bankokból származó, állami garanciájú kölcsönök a magán és állami szektorban található vállalkozások részére csak szolid mértékben fognak emelkedni az elkövetkezendő öt évben a tanulmány alapváltozata szerint. Az ipari országok kereskedelmi bankjaiból eredő közép- és hosszútávú kölcsönök kifizetése az 1991-es két milliárd dolláros szintről öt milliárd dollára fog emelkedni 1995-re.

Európai bankok nyújthatják majd a legtöbb hitelt úgy export finanszírozóként mint hivatalos ügynökségek társfinanszírozóiként. A térség kormányai és egyéni vállalkozások közvetlenül is kölcsönözhetnek az ipari országok tőkepiacairól, de a jelenlegi példák elemzése szerint a térségbe irányuló tőkebeáramlás valószinüleg korlátozott fog maradni. Helyi vállalkozásokba és a keletkezőfélben levő belföldi tőkepiacra irányuló közvetlen tárcaberuházások csak lassan fognak növekedésnek indulni. Habár jónéhány közvetlen külföldi beruházást bejelentettek már, másokat már el is kezdtek és még kétségtelenül több fog beindulni, az ezekhez kapcsolódó tőkebeáramlás várhatóan csak több éves időperiódus alatt fog fokozatosan konkretizálódni.

Az alapváltozatban található értékelés szerint a térség, mint egységes egész számára történő hivatalos és magánforrásból eredő közép- és hosszúlejáratú hitelkifizetések 13 milliárd dollárról 18 milliárd dollárra fognak emelkedni 1992 és 1995 között. Ezenkívül a részvények beáramlása az 1991-es 1 milliárd dolláros szintről mintegy 2,5 milliárd dolláros szintre fog emelkedni 1995-re, ami összességében 10 milliárd dollárt fog kitenni a tárca- és direktberuházásokkal együtt az elkövetkezendő öt évben.

A reform gyorsabb gondolata, a gyorsabb növekedés és a külföldi finanszírozás gyorsabb kialakulásának gondolatával társítható. Kezdetben a hivatalos finanszírozási forrásoknak el kell érniük egy nyereséges szintet.

A felgyorsított reformváltozat szerint a hivatalos közép- és hosszútávú finanszírozás kifizetései 1993 és 1994-ben 15%-kal lesznek magasabbak az alapváltozat adataiénál. Hangsúlyozni kell azonban, hogy a segélyprogramok beindításához szükséges időt tekintve az 1993-as kifizetések ilyen mértékű emelkedése a reformfolyamat nagyon korai felgyorsításának a függvénye. A kifizetések növekedése a későbbiekben csupán 5%-kal fogja meghaladni az alapváltozatban jelzett 1995-ös értéket, mivel ekkorra a reform már eléggé előrehaladott állapotban lesz ahhoz, hogy tekintélyes növekedést biztosítson az adósság és a részvényfinanszírozást szolgáló magántőke beáramlásában.

A felgyorsított reformváltozat szerint a magánforrásból származó kölcsönnyújtások összege az 1993-as évi 3 milliárd dolláros szintről 1995-re 7 milliárd dollárra emelkedik, a külföldi közvetlen beruházások pedig az 1993-as évi 2 milliárd dolláros szintről 1995-re 7 milliárd dollárra ugranak. Így e második változat szerint a magánrészvény-beáramlás és a közvetlen külföldi beruházás együttesen több mint 15 milliárd dollárt fog kitenni az 1991 és 1995 közötti öt éves időszakban.

Ezen magánforrású beáramlások azonban a térség együttes tőkeszükségleteihez viszonyítva aránylag alacsonynak tűnhetnek. Újabb értékelések szerint az egyes államok privatizációs programjai külön-külön is könnyedén be tudnának fogadni ilyen nagyságrendű összegeket.

A privatizálandó állami vagyonok ilyen irányú értékeléseit azonban felül kell vizsgálni és lefelé módosítani. Minden bizonnyal a privatizáció tempója nem csökkenhet az állami vagyonok előre meghatározott árainak realizálására tett kísérletek miatt. Sokkal jobb megoldás lehet a belföldi források megmozgatását szolgáló erők növelése; evvel hangsúlyozandó a térség gazdasági szektorai átalakításának fontosságát.

A térség kormányainak saját erőfeszítésükkel kell szorgalmazniuk a magántőke-beáramlást általában és közvetlen külföldi beruházásokat különösképpen; tekintet nélkül azok jelenlegi volumenére. Amint ezen kormányok megfelelő módon átszerveződnek, a külföldi vállalatok hozzák magukkal a technológiát, a vezetési módszereket és az ipari országok piacaira a belépőt. Talán még fontosabb, hogy a közvetlen külföldi beruházásokat támogató intézkedések ugyanazok a lépések, amelyek a virágzó belföldi magánszektor megteremtéséhez szükségesek.

Külső felelősségek

Az első időszakban a tőkebeáramlás nagyobb része hivatalos ügynökségektől kell hogy származzon. Alapvető feltétel, hogy a külső segítség jól megtervezett és valójában szükséges legyen. Humanitárius segélyeket kivéve csak azon országok juthatnak segélyhez, amelyek komoly és hosszan tartó erőfeszítéseket tesznek az átalakítás érdekében.

E jelentés felvázolta a reform, a külső anyagi beáramlás és a fenntartható gazdasági növekedés közötti kapcsolatot. Az ipari országoknak és a multilaterális ügynökségeknek teljesen meg kell jeleníteniük a kapcsolat lényegét a térség országaival folyó tárgyalásaik során és el kell kötelezniük magukat arra is, hogy soron kívüli támogatást biztosítsanak, ha az átalakítás folyamata felgyorsul.

A multilaterális intézmények azon lehetőségeit, hogy nemzetközi tőkepiacokon pénzt tudnak teremteni, ki kell használni, amilyen mértékben csak lehet, mert ezáltal elkerülhetők olyan költségvetési problémák, amelyek politikailag jelenleg zavaróak lennének néhány ipari országban. Abban az esetben, ha a térség ki akarja használni teljes gazdasági lehetőségeit, a multilaterális intézmények nemcsak abban játszhatnak kulcsszerepet, hogy ellátják a magánszektor és a szerkezetváltás finaszírozását, hanem abban is, hogy kiterjesztik technikai segítségnyújtásukat és segítenek felkészülni a jelentős mennyiségű magántőke beáramlásának fogadására.

Utóljára pedig hangsúlyozni kell, hogy az iparilag fejlett országok minden tőlük telhetőt meg kell tegyenek annak érdekében, hogy saját piacukon, a kelet-európai országok export termékei, szabad hozzáférhetőséget élvezhessenek.

Ez főleg a mezőgazdasági cikkek területén játsik fontos szerepet. És, főleg a földrajzi piacközelség szempontjából, Kelet Európa rézére a legnagyobb előnyöket azok as Európai Közös Piac által tett lépések fogják jelenteni, amelyeket e teren fognak kivitelezni.

Az idő rövid

Kelet-Európa országainak két, legjobb esetben három évük van arra, hogy gazdasági rendszerükben visszavonhatatlan változtatásokat vigyenek végbe. A reformfolyamat maga kétségtelenül több időt fog igénybevenni. A legalapvetőbb reformoknak azonban korán végbe kell menniük, mert különben az egész folyamat veszélybe kerülhet, és a külföldi tőke beáramlása elapadhat. Az átmeneti idő alatt a kétségtelenül magasabbra emelkedő munkanélküliség és az alacsonyabb életszinvonal terhét magukon
viselő egyének türelme valószínüleg el fog fogyni, ha a javulás

lehetősége nincs a láthatáron. A gyorsítás növelésére és a magántőke behozatalára tett lépések meghatározatlan időre hatásukat veszthetik támogatás nélkül és az a lendítőerő, amely a térség országait a nemzetközi gazdasági rendszerbe próbálta kapcsolni, legyengülhet.

A folyamatnak azonban jó esélye van arra, hogy sikeresen befejeződjék, feltéve, ha a reform felgyorsul és a külső támogatás elégséges. Habár az ipari országok remélni sem merték, hogy Kelet-Európában az elmúlt két évben lezajlott politikai fordulat bekövetkezzék, mégis az egész világ élvezné előnyeit annak, ha a térség országai majdani virágzó és stabil gazdaságukkal beilleszkednének a nemzetközi gazdasági rendszerbe. Az ipari országok ezért erősen érdekeltek abban, hogy megnyissák piacaikat és kiterjesszék segítségüket. A térség kormányai pedig erősen érdekeltek a reform előrevitelében. Össze kell fogniuk tehát, hogy céljukat elérjék és megfeleljenek e történelmi kihívásnak.

Annex 5

Podsumowanie i Wnioski

Rozwój wypadków w Europie Wschodniej w ostatnich dwóch latach, przekroczył pod wieloma względami wszelkie oczekiwania. Gdy Związek Radziecki dopuścił do narastania populistycznych różnic zapatrywań w Polsce i w N.R.D., a w końcu do obalenia ustalonych reżimów, szybkie i decydujące kroki ku demokracji podjęte zostały w wielu regionach. W szczególności, uległy zmianie warunki polityczne we wszystkich sześciu krajach wymienionych w raporcie: w Bułgarii, Republice Czeskiej i Słowackiej, na Węgrzech, w Polsce, Rumunii i w Jugosławi. Większość z tych krajów które uczestniczyły w tym procesie stworzyło podwaliny dla historycznych przeobrażeń z gospodarek planowanych centralnie na gospodarki wolnorynkowe.

Występowały jednakże istotne różnice w stopniu przeobrażeń gospodarczych. Polska dokonała największych postępów adoptując w krótkim okresie, szeroki program mikro- i makro- gospodarczych reform, a rezultat wyborów prezydenckich w Polsce z listopada 1990 roku, sugeruje, że rozpęd ten się utrzyma. Znaczący, jeśli nie bardziej dojrzały postęp wystąpił na Węgrzech, które od wielu już lat zmierzały w kierunku gospodarki rynkowej. Znaczące reformy gospodarcze zadziałały w Jugosławi. Mimo opóźnionego startu, CZFR ukształtowała swój własny silny program. Jedynie Bułgaria i ^Rumunia zaledwie zaadoptowały makro-ekonomiczne dostosowania programów, wiele więc wysiłków musi jeszcze zostać podjętych dla stworzenia postępu strukturalnych reform i rozpoczęcia wprowadzania ich w czyn.

Pierwszy etap reform gospodarczych — odrzucający centralnie planowane nakazy gospodarcze i zorientowany na zarządzanie gospodarcze oparte na metodach rynkowych — został całkowicie wypełniony. Akty prawne zostały zaproponowane lub wprowadzone w życie, jak również zawarte zostały pewne kluczowe porozumienia. Nadchodzi teraz etap drugi — sprawdzający trwałość politycznych orientacji — gdy jednocześnie wyłaniają się i wcielane są w życie nowe polityki.

Niniejszy raport dotyczy zasadniczo spraw dotyczących warunków zewnętrznego finansowania sześciu krajów w kilku nadchodzących latach. Jednak z powodu dostępności i użyteczności finansowania zewnętrznego, nierozerwalnie związanego ze stopniem w jakim kraje te odtwarzają swoje dawne instytucjonalne porozumienia i tworzą nowe, które są konieczne — raport ten omawia także postęp i perspektywy krajowych reform.

Dostosowanie i stabilizacja krajowa

Rządy krajowe w tym regionie kontrolują niemal wszystkie podstawowe dziedziny polityki ekonomicznej, koncentrując się wokół problemu jak efektywnie połączyć stabilizację z szerokim zakresem strukturalnych dostosowań. Wszystkie rządy uznają obecnie potrzeby wprowadzenia fiskalnych i monetarnych polityk dla stabilizacji własnych gospodarek, podczas gdy rozwijane są i wprowadzane reformy systemowe. Opanowana została polska hiperinflacja, a jugosłowiańska zredukowana, w tym samym czasie węgierski deficyt rachunków bieżących został zestornowany, a deficyt budżetowy wyeliminowany. Działając w różnym tempie, wszystkie z krajów tworzą niezbędne prawne i ekonomiczne ramy które ustanawiają i zabezpieczają prywatne prawa własności. Wszystkie sześć adoptują także standardy księgowości i inne rozwiązania praktyki ekonomicznej krajów uprzemysłowionych. Z czasem, elementy te podniosą jakość informacji ekonomicznych dostępnych dla przedsiębiorstw i gospodarstw domowych i znakomicie podniosą efektywność podejmowanych decyzji gospodarczych.

Każdy z rządów podjął inicjujące kroki dla stworzenia nowoczesnego systemu bankowego — oddzielając funkcje banków centralnych i banków handlowych. Cele są jasne: stworzenie systemu mogącego zmobilizować krajowe oszczędzanie i udostępnić kredyty na warunkach rynkowych oraz służyć jako efektywny system płatniczy. Rządy tych krajów rozpoczęły także rozwijać krajowe rynki kapitałowe. Programy prywatyzacji zostały wprowadzane i zaczęły działać w Polsce i na Węgrzech, a w drodze jest deregulacja cen i stopy procentowej. Dla zabezpieczenia nowych bezrobotnych stworzone lub wzmocnione zostały systemy pomocy. Liberalizowany jest handel zagraniczny i rozszerzana wymienialność walut.

Jednak jeszcze wiele więcej potrzeb musi być zaspokojonych dla osiągnięcia tak głębokiej reorganizacji gospodarczej.

Gwałtowne wprowadzenia w czyn

Charakter wzajemnych powiązań tych reform naświetla potrzeby ich szybkiego zaprezentowania. Ich równoczesne i wszechstronne wprowadzenie wydaje się niemożliwe, nawet w tych krajach, które zdecydowały się na gwałtowne zmiany. Jednak następstwo polityczne jest potencjalnie tak problematyczne, że może okazać się bardziej rozsądne oddziaływanie na kilku frontach, tak szybko jak to jest możliwe. Uwzględnijmy na przykład powiązania pomiędzy finansowym sektorem reform, polityką monetarną i kredytową, deregulacja i prywatyzacją;

- Reformy kontrolujące ekspansje krajowych kredytów i powstrzymujące presje inflacyjne związane z deregulacją cen byłoby trudne bez sektora finansowego.
- Bez liberalizacji cen i handlu, wycena wartości prywatyzowanego majątku byłaby ciężka, a bez zreformowanego sektora finansowego, kanały mobilizujące przeznaczanie oszczędności sektora prywatnego na zakup przedsiębiorstw stanowiących własność państwową byłyby ograniczone.
- Ponadto, bez prywatyzacji reformy w ramach sektora finansowego powinny przebiegać wyłącznie jak dotychczas.

Chociaż w.wym warunki wewnętrzne są kompleksowe i trudne do przypisania, nie mogą one zostać użyte dla usprawiedliwiania powolnego procesu przeobrażeń.

Podstawowe zmiany

Korzystne przeobrażenia będą wymagały fundamentalnych zmian w wiedzy, zdolnościach i zachowaniach zarówno urzędników administracji jak i zwykłych obywateli. Dla rządów w tych regionach, liberalizacja i reforma oznacza utratę kontroli. Przedstawiciele rządowi muszą dokonać przejścia od wyznaczania kilku dozwolonych działalności gospodarczych do zakazywania kilku działalności zakazanych, pozostawiając przedsiębiorstwom i gospodarstwom domowym swobodę działania i współpracy, całkowicie pozbawiając je bezpośredniego nadzoru. Nowe przedsiębiorstwa muszą mieć możliwości rozwoju, a — z całkowitymi konsekwencjami jakie tylko możliwe — stare przedsiębiorstwa muszą mieć możliwości upadku. Firmy działające bieżąco w sektorze publicznym muszą mieć możliwości zaniechania działalności o ile nie są zdolne do ekonomicznego utrzymania się.

Ponieważ kierowanie gospodarcze stało się bardziej subtelne stając się jednocześnie mniej bezpośrednim, jakość sektora publicznego wykonującego funkcje ekonomiczne rządu powinna być podniesiona, nawet przy obcięciu zatrudnienia — nadzwyczaj trudne publiczno-administracyjne wyzwanie.

Robotnicy w tym samym czasie, tak samo jak właściciele i kierownicy w sektorze prywatnym, muszą być raczej przygotowani nie do oczekiwania na instrukcje, a do przejęcia inicjatywy i do działania dla dobra własnego przedsiębiorstwa gdy tylko nadarzy się sposobność. Jednostki te muszą zajmować się nieskończoną ilością gości dla wyszukania i usatysfakcjonowania klienta, co jest centralnym procesem przedsiębiorstw prywatnych. Nagrodą za takie działania będzie zysk, dobrobyt i dochody przewyższające średnią. **Zyski i spekulacja** nie powinny być widziane jako terminy pejoratywne, a nierówność dochodów muszą być uznawane za nieodzowne składniki gospodarki rynkowej.

Oprócz akceptacji takich zmian w nastawieniach, rządy nie mogą — i nie powinny — wiele czynić dla ich przyspieszenia. Pod wieloma względami upadek komunizmu wynikł z bezowocnych poczynań rządowych do kierowania zmianami indywidualnych przekonań.

Powtórzenie błędów z przeszłości w imię kapitalizmu byłoby katastrofalne.

Realistyczne oczekiwania

Istnieje potrzeba zabezpieczenia przed nierealistycznymi oczekiwaniami natychmiastowego wzrostu dobrobytu gospodarczego. Trudno jest sobie wyobrazić życiowy standard Europy Wschodniej wzrastający w ciągu najbliższych pięciu, czy nawet dziesięciu lat do poziomu równego z krajami uprzemysłowionymi, chociaż przed połową dekady tempo wzrostu w niektórych regionach może znacznie przekroczyć średnią osiąganą przez kraje uprzemysłowione. Razem z redystrybucją zysków, która nieuchronnie musi towarzyszyć strukturalnym dostosowaniom, powolny wzrost może uniemożliwić wielu ludziom w tym regionie osiąganie przez pewien okres czasu należnych im korzyści.

Specyficzne dostosowania

Jako dodatek do tego panaceum musi być zastosowanych wiele specyficznych przedsięwzięć, o ile reforma ma posunąć się do punktu w którym przypływ prywatnego kapitału znacząco wzrośnie. Z pośród środków omawianych w głównej części raportu, n.wym. powinny być uwypuklone:

- Naczelnymi priorytetami w sektorze prywatnym są deregulacje stopy procentowej i zaniechanie alokacji kredytów przez państwo. Nowo utworzone banki handlowe muszą stać się niezależnymi organizacjami z mocnymi wyważeniami oraz ze zdolnością do działania jako efektywny przewodnik od oszczędności do inwestycji, jako dostawca kredytów na warunkach rynkowych dla pożyczkobiorców godnych kredytu, oraz jako wydajny komponent systemu płatniczego. Potrzebni będą także inni finansowi pośrednicy, ale na tym etapie tworzenie solidnego i odpowiedzialnego systemu banków handlowych posiada pierszeństwo.

- Wyposażenie zagranicznych banków w gotowy dostęp do krajowych rynków Europy Wschodniej powinno dopomóc w stworzeniu takiego systemu. Bliźniacze rozwiązania, takie jak wprowadzone przez International Finance Corporation (I.F.C.) między bankami polskimi, a zagranicznymi prywatnymi bankami handlowymi, będą także bardzo pożądane. Konieczne jest skoncentrowanie wysiłków dla szkolenia personelu bankowego analizującego projekty pożyczek, szacujących kredyty dla pożyczkobiorców i wykonujących takie rutynowe zadania jak analizy finansowe. Pożądana jest stała bilateralna i multilateralna pomoc techniczna dla centralnych banków w tym regionie, dla pomocy w projektowaniu i wdrażaniu systemów nadzorczych. W tym samym czasie należy zachęcać do rozwoju krajowych rynków kapitałowych, zarówno dla papierów wartościowych jak i dla akcji zwykłych. Chociaż rynki kapitałowe nie muszą być wielkie, ani rozwinięte technologiczne, koncept współdziałania z nimi i działania na nich powinien być stale nurtowany.
- Prywatyzacja powinna postępować szybkimi krokami. Poza oczywistymi możliwościami, że wyprzedaż majątku państwowego doprowadzi do przypływu obcego kapitału, przejście własności państwowej w ręce prywatne wymaga uzyskania większej pewności, że środowisko krajowego biznesu

będzie dla obcego kapitału gościnne. Pomyślny program prywatyzacji zapewnia dwie rzeczy: ustanowienie zyskownych, niezależnych przedsiębiorstw; oraz zamknięcie przedsiębiorstw które nie są zdolne do przetrwania. Chociaż cele maksymalizacji dochodów do kieszeni publicznej i szerokie rozdzielnictwo własności jest ważne politycznie, to rozwój zdolnych do przetrwania przedsiębiorstw jest najważniejszym rezultatem racjonalizacji własności przemysłowej, zarządzania i struktury.

- Tworzenie i rozwój prywatnych przedsiębiorstw musi także być popierane poza procesem prywatyzacji. Tam gdzie licencje są wymagane, powinny być one wydawane natychmiastowo. Polityka publiczna sprzyjać musi rodzącym się prywatnym przedsiębiorstwom przez bycie bezstronnym w sprawie alokacji dostępu do publicznych dóbr i usług i wszelkie środki powinny być podjęte dla zapewnienia, że te zasady są rzetelnie wypełniane.
- Na tyle na ile dotyczy to liberalizacji wymiany towarów jak i waluty, postęp w kierunku otwartości musi być kontynuowany. Jasnymi celami są: pełna wymienialność; jeden kurs walutowy; ujednolicone i relatywnie niskie opłaty taryfowe i nieograniczanie przepływu towarów, usług i pieniądza. Ustanowienie stabilnego i otwartego systemu cenowego, konkurencyjnych kursów wymiany i otwarcie rynku kapitałowego wymagane są jako warunki wstępne dla pełnej integracji z międzynarodowym systemem ekonomicznym.
- Doznając krótkookresowych zakłóceń w wymianie handlowej, rządy regionów powinny uwzględnić propozycję stworzenia mechanizmów reasekuracyjnych dla lokalnych agencji

udzielających gwarancji na kredyty eksportowe z poparciem krajów uprzemysłowionych. Może to być zorganizowane za pośrednictwem jednej z multilateralnych agencji jako inicjatywa polegająca na tym, że wszystkie kraje w regionie będą się wspólnie popierały, pomagając w finansowaniu wymiany pomiędzy nimi dopóki ich własne agencje udzielające gwarancji na kredyty eksportowe nie zostaną ustanowione na międzynarodowym rynku kapitałowym

- Dążenie do podniesienia jakości informacji ekonomicznej dostępnej dla sektora prywatnego wymaga wzmocnienia. Nie tylko standard rachunkowości krajów uprzemysłowionych i jawność powinny zostać wdrożone tak szybko jak to jest możliwe, ale potrzebny jest także wielki udział wsparcia technicznego na poziomie użytkowników, dla edukacji managerów, inwestorów i pracowników obsługi o niuansach metodologii rachunkowości i środków.

Pomijając nieuchronne potknięcia po drodze, kierunek i rozpęd reform musi być podtrzymywany – od inicjujących porozumień politycznych, poprzez prawodawstwo, do polityki wdrożeniowej. Kontynuowane oficjalne finansowanie, uwarunkowane będzie czynionymi postępami. Finansowanie prywatne stanie się znaczące jedynie wówczas, gdy podstawowe reformy staną się nieodwracalne i powstanie trwała polityczna jednomyślność, że kierunek reform powinien być utrzymany.

Zanim uwzględnimy konkluzje opracowania dotyczącego charakteru i wyszczególnimy potrzeby finansowania zewnętrznego, powinniśmy stwierdzić jeden dodatkowy punkt dotyczący polityki krajów uprzemysłowionych w sprawie regionu. Rozszerzenie dostępu dla przedsiębiorstw Europy Wschodniej do rynków rolnych, przemysłowych i konsumpcyjnych krajów uprzemysłowionych byłoby nadzwyczaj trudne. Główne wysiłki na tym froncie muszą uczynić kraje uprzemysłowione. Rzecz nie polega bowiem na zalecaniu systemu ekonomicznego opartego na rynku, a następnie wstrzymywaniu głównych form wsparcia wymaganego do osiągnięcia przeobrażeń. Na skalę globalną, sukces multilateralnych negocjacji bieżącej Rundy Urugwajskiej będzie istotny. Na skalę regionalną, ciężar wzrastającej otwartości spoczywa całkowicie na Wspólnocie Europejskiej.

Finansowanie przeobrażeń

Jeżeli dalekosiężne programy reformy mają być kontynuowane i jeśli gospodarki regionu gotowe są wkroczyć na ścieżkę niepowstrzymanego wzrostu tak szybko, jak to jest tylko możliwe, to wymagany będzie istotny dopływ finansowania.

Warunki w Europie Wschodniej zmieniły się tak drastycznie, a zmiany następują tak gwałtownie, że przewidywania potrzeb i źródeł finansowania są w najlepszym razie zaledwie ilustracją tego, co możesię stać. W rezultacie recesji gospodarek anglosaskich jak również napięcia wywołanego przez zjednoczenie Niemiec, warunki w krajach uprzemysłowionych także uległy zmianie. Niezależnie od powyższego, Zespół Opracowujący przyjął pogląd, że użtyecznie będzie określić ilościowo problemy finansowania zewnętrznego stojącego przed krajami w regionie.

Cztery czynniki odnoszą się do potrzeb finansowych w regionie. Po pierwsze, Polska wymaga finansowania do obsługi starych długów, niezależnie od ostatnich umożeń długów przez oficjalnych kredytodawców. Pomimo, że przez następne dwa, albo trzy lata kraj ten będzie osiągał prawdopodobnie nadwyżki w swoich transakcjach zewnętrznych przed obsługą długu, to wymagane jednak będzie znaczne finansowanie dla obsługi pozostających zobowiązań płatniczych.

Po drugie, bilans płatniczy każdego kraju w regionie ulega pogorszeniu jako rezultat zmian w warunkach handlowych ze Związkiem Radzieckim. Cena ropy naftowej wyceniona w.g. realistycznego kursu wymiany na bazie starego rubla transferowego, rozliczana w ramach Rady Wzajemnej Pomocy Gospodarczej (R.W.P.G.), wynosiła 7 dolarów za baryłkę. Na nowych warunkach jakie weszły w życie w styczniu 1991 r., średnia cena urasta do poziomu cen na rynku światowym i musi być płacona w walucie wymienialnej. Poza tym, oczekiwany jest spadek wartości jednostkowej wschodnio europejskiego eksportu do Z.S.S.R. w wyniku powstałej bezpośredniej konkurencji towarów z krajów uprzemysłowionych.

Po trzecie, proces przeobrażeń sam w sobie wymaga zasobów. Jakakolwiek jest zdolność zmobilizowania krajowych zasobów, gospodarki te mogą potrzebować zewnętrznego finansowania na opłacanie importu. Jeśli procesy liberalizacji importu zostaną przyspieszone, co pomoże zapewnić, że zapowiadający się sektor prywatny jest w rzeczywistości wydajny — wzrost importu prawdopodobnie przekroczy wzrost wartości krajowego Produktu Globalnego (GNP) o szeroki margines, nawet jeśli import wyrobów konsumpcyjnych będzie utrudniany.

Ostatecznie, słabość krótko okresowych perspektyw gospodarczych krajów uprzemysłowionych, a bardziej drastycznie, upadek sowieckiej gospodarki oznacza, że będzie mniej szans eksportowych niż mogło by być w innych warunkach. Wartść i ilość eksportu bez wątpienia wzrośnie w końcu, ale nie tak szybko jak to by powinni nastąpić.

Możliwe scenariusze

Wpływ tych i innych czynników oddziaływujących na przyszłe finansowanie zewnętrzne zbadane zostało w podstawowych scenariuszach w tym raporcie. W tym scenariuszu, krajowy Produkt Globalny zmaleje zarówno w 1991 r. jak i w 1992 r., a od 1993 r. w większości regionu zacznie wzrastać. Do roku 1995 średnioroczny wzrost wynosił będzie niewiele ponad 3 procent, zakładając, że nie nastąpi żaden przyszły zewnętrzny szok i że tempo reform ekonomicznych zostanie utrzymane.

Dla potencjalnych inwestorów w tym regionie, ta mniej niż optymistyczna perspektywa budzi poważne zaniepokojenie o utrzymywalność reform: Czy przedłużające się i szerokie trudności ekonomiczne nie zachwieją akceptacji publicznej procesu reform?

Dla ograniczenia takiego ryzyka, reformy gospodarcze powinny zostać przyspieszone. W krajach które tego nie dokonały, istnieją wszelkie powody dla całkowitej liberalizacji handlu, dla ustanowienia jasnych przepisów i zasad postępowania dla inwestycji zagranicznych oraz dla szybkiego optowania za wymienialnością waluty w.g. jednego, realistycznego kursu wymiany. Bezpośrednie kroki które powinny wzmocnić sektor finansowy przewidują całkowitą liberalizację stopy procentowej, zezwolenie na konkurencję zagraniczną oraz wzmocnienie balansu rozrachunkowego nowo utworzonych banków. Znacznie trudniejsze, choć nie mniej pilne kroki przewidują popieranie rozwoju prywatyzacji i zamykanie umierających przedsiębiorstw które na gospodarkę regionu działają jak hamulce. Bez względu na to, że takie środki zaradcze mogą wywołać zaburzenia i doprowadzić do wzrostu trudności w bardzo krótkim czasie, to znacznie szybciej powinny poprawić wydajność gospodarczą oraz doprowadzić do mobilizacji i alokacji zasobów krajowych, aby w ten sposób przyspieszyć dzień w którym wzrost powróci na nowo.

Dla przeegzaminowania możliwych rozczłonkowań wzrastających kroków reformy, raport niniejszy zawiera także drugi scenariusz ilościowy. Pomimo, że przyspieszone reformy spowodują wzrost zapotrzebowania finansowego, to powinny one spowodować także rozkwit chłonnych regionalnych zapotrzebowań na zewnętrzne finansowanie, zachęcanie oficjalnego wsparcia z zagranicy i uzyskanie większych napływów finansowych z sektora prywatnego. Z powodu tych efektów ubocznych, przewidywane korzyści — w warunkach szybszego wzrostu i rosnącego finansowania zagranicznego — mogą okazać się dość istotne. Scenariusz alternatywny sugeruje, że jeśli tempo reformy ulegnie przyspieszeniu, to krajowy P.G. w 1993 r. może gwałtownie podskoczyć, oraz że średnie tempo rocznego wzrostu może do 1995 r. przekroczyć 5 procent. W.g. podstawowego scenariusza, zapotrzebowanie na finansowanie zewnętrzne wzrasta z 36 mld. dolarów w 1991 r. do 52 mld. dolarów w 1995 r. Pomimo tego że bilans rachunków bieżących regionu jako całości podnosi się z poziomu deficytu z grubsza 12 mld. dolarów do poziomu około 8 mld. dolarów, amortyzacja należna z tytułu średnio- i długo- terminowych kredytów (przed redukcją zadłużenia) wzrasta od 10 mld. dolarów do około 17 mld. dolarów.

Możliwości finansowania

Ten poziom finansowania wydaje się być całkowicie wykonalny. W minionych dwóch latach, odpowiedzi zarówno z sektora prywatnego jak i publicznego były zachęcające. Programy reform w regionie spotkały się z wyraźnym zaufaniem i dobrą wolą krajów uprzemysłowionych.

Nie mniej jednak, spodziewać się można trafności przewidywań, że rządy krajów uprzemysłowionych, jak również przedsiębiorstwa prywatne planują w najbliższej przyszłości napływ finansowania do Wschodniej Europy na wielką skalę. W szczególności, relatywnie wielkie zgłoszenia napływu kapitałów do byłej Niemieckiej Republiki Demokratycznej (N.R.D.) z Niemieckiej Republiki Federalnej i innych państw uprzemysłowionych nie powinny być użyte jako punkty odniesienia. W rzeczywistości w najbliższym terminie, zakres użytecznej pomocy — i prawdopodobieństwa jej dostępności — jest pomniejszany przez skalę systemowych przeobrażeń jakie region przechodzi.

Krótkookresowe perspektywy napływu prywatnych kapitałów wydają się być ograniczone, nawet w najlepszych z istniejących warunków. Niektóre wpływy kapitałowe skierowane zostały do Niemiec Wschodnich ze względu na istnienie tam relatywnie korzystnejszych szans, oraz na pozostawanie biurokratycznych utrudnień gdziekolwiek indziej we Wschodniej Europie — w stopniu podobnym jak polityki są wdrażane, zarówno jak i w samych politykach. Niektóre z obiecujących inwestycji nie zostały zrealizowane, bądź to z powodu nierealistycznych wymagań rządów, bądź z powodu niepewności co do warunków i terminów — lub nawet z powodu partnerów. W skrócie, transakcje są trudne do przeprowadzania.

W każdym przypadku, najwidocznie kilka możliwości jest dostatecznie zyskowne by zagwarantować pokrycie trudności i ryzyka z tym związanego. Bariery językowe, uboga infrastruktura i problemy ochrony środowiska będą w dalszym ciągu powstrzymywać napływ prywatnego kapitału do Europy Wschodniej. Występuje niepewność co do praw własności i kontroli dóbr oraz praw inwestorów zagranicznych w przypadku powstania rozbieżności. Także wartość dóbr jest trudna do określenia ponieważ nie istnieją historyczne zapisy rachunkowe, ani ceny zdeterminowane poprzednio wartością rynkową, w.g. których nakłady i wyniki przedsiębiorstw mogą być wyceniane.

W.g. podstawowego scenariusza, udzielanie kredytów przez banki zagraniczne lokalnym przedsiębiorstwom – zarówno prywatnym, jak i stanowiącym własność państwową, posiadających lub nie niezależne gwarancje – wzrośnie umiarkowanie w okresie nadchodzących pięciu lat. Płatności średnio- i długo- terminowych kredytów zaciągniętych w bankach handlowych krajów uprzemysłowionych wzrośnie z 2 mld. dolarów w 1991 r. do 5 mld. dolarów w roku 1995.

Banki europejskie będą dostarczycielami większości kredytów, na finansowanie eksportu lub jako współ-finansowanie z oficjalnymi agencjami. Przedsiębiorstwa indywidualne oraz rządy w regionach mogą pożyczać bezpośrednio na rynku kapitałowym krajów uprzemysłowionych, jednakże ostatnie nieodosobnione przypadki dowodzą, że powstały napływ kapitałów zostanie prawdopodobnie ograniczony. Powoli powinien wzrastać z prawie nieistniejącej bazy portfel inwestycji bezpośrednio na regionalne przedsiębiorstwa i na dopiero rodzący się rynek kapitałowy. Ponadto, mimo że kilka bezpośrednich inwestycji zagranicznych zostało ogłoszonych, oczekuje się, że związany z tym napływ kapitałów będzie materializował się stopniowo, w miarę upływu lat.

W podstawowym scenariuszu ogólne płatności średnio- i długoterminowych kredytów zaciągniętych zarówno ze źródeł oficjalnych jak i z prywatnych dla regionu jako całości wzrośnie w latach pomiędzy 1992 i 1995 rokiem z około 13 mld. dolarów do 18 mld. dolarów. Ponad to, napływ kapitału po zaspokojeniu wierzytelnych pretensji wzrośnie od około 1 mld. dolarów 1 1991 do około 2,5 mld. dolarów w roku 1995, na ogólną kwotę 10 mld. dolarów nowego portfela i bezpośrednich inwestycji na przestrzeni nadchodzących pięciu lat.

Szybsze reformy powinny być związane z szybszym wzrostem, oraz z szybszym stworzeniem finansowania zewnętrznego. Początkowo, oficjalne źródła finansowania będą musiały napotykać wzrastające potrzeby.

W.g. scenariusza przyspieszonych reform wypłaty z oficjalnego średnio- i długo- terminowych finansowań w 1993 r. i aż do 1994 r. przewidywane są o 15 procent wyżej niż założono w podstawowym scenariuszu. Powinno być podkreślone, że z punktu widzenia czasu wymaganego dla przyspieszenia programów pomocy, wzrost tej wielkości wypłat przewidywany w 1993 r. jest uzależniony od tego czy reformy ulegną przyspieszeniu w szybkim czasie. Wzrost w wypłatach zostanie następnie ustalony na poziomie 5 procent powyżej tego jaki przewidziany został w podstawowym scenariuszu w 1995 r., kiedy to powinno nastąpić znaczne przyspieszenie reformy, wliczając w to istotny wzrost napływu kapitałów prywatnych, zarówno dla finansowania zadłużenia jak i kwot pozostających ponad spłatę.

W scenariuszu przyspieszonych reform, wzrost kredytowania prywatnego z 3 mld. dolarów w 1993 r. do 7 mld. dolarów w roku 1995 i fale bezpośrednich inwestycji zagranicznych z 2 mld. dolarów w 1993 r. do ponad 7 mld. dolarów do roku 1995. Tym sposobem, w tym drugim scenariuszu, napływ prywatnych kwot pozostających ponad spłatę i bezpośrednich inwestycji zagranicznych osiągną łącznie ponad 15 mld. dolarów w okresie 5 lat 1991 do 1995.

Te prywatne napływy mogą z powodzeniem wydawać się małe w relacji do zapotrzebowania na kapitały w całym regionie. Opierając się na przybliżonych bieżących wyliczeniach, programy prywatyzacji w poszczególnych krajach wydają się same w sobie bardziej niż zdolne do pochłonięcia tych sum. Jednakże te wyliczenia wartości mającego uledz prywatyzacji majątku państwowego mogą okazać się konieczne do zaniżenia. Rzeczywiście, tempo prywatyzacji nie powinno zostać zwolnione w dążeniach do realizacji ustalonych z góry cen na majątek państwowy. Lepszym kursem powinno być podwojenie wysiłków dla pozyskania zasobów krajowych, które podkreślają ważność reform sektora finansowego regionu.

Rządy w regionie powinny wzmocnić swoje wysiłki dla zachęcania napływu kapitałów prywatnych w ogóle, a bezpośrednich inwestycji zagranicznych w szczególności, bez względu na to jak małe mogą one w tym czasie być. Jak zostało to dobrze przez rządy rozpoznane przedsiębiorstwa zagraniczne przynoszą ze sobą technologie, sprawność zarządzania i wprowadzenie na rynki krajów uprzemysłowionych. Być może bardziej ważnym jest, że miarą dla zachęcania napływu bezpośrednich inwestycji zagranicznych są te same miary wymagane dla stworzenia kwitnących prywatnych sektorów w kraju.

Zewnętrzne odpowiedzialności

Przede wszystkim, strumień napływów kapitałowych powinna nadejść z oficjalnych agencji. Istotnym jest, aby to zewnętrzne wsparcie było dobrze opracowanie i prawdziwie potrzebne; a z wyjątkiem na pomoc humanitarną, powinno być udzielane jedynie tym krajom, które dokonują poważnych i istotnych wysiłków na rzecz reformy.

Raport niniejszy uprościł wzajemne relacje pomiędzy reformami, napływem zewnętrznego finansowania i niepowstrzymanego wzrostu ekonomicznego. Kraje uprzemysłowione i agencje multilateralne muszą bardziej pełnie określić te stosunki w swoich dyskusjach dyplomatycznych z rządami regionu i powinny być przygotowane do przejęcia na siebie zobowiązania wyłożenia dodatkowych funduszy jeśli reforma ulegnie przyspieszeniu.

Należy nieodwołalnie położyć nacisk na to, by kraje uprzemysłowione uczyniły wszystko co tylko możliwa, dla zliberalizowania dostępu do swoich rynków dla eksportu wschodnioeuropejskiego. Jest to szczególnie istotne dla produtów rolniczych. Jako nieodzowny rezultat bliskiego sąsiedztwa, największe korzyści dla Europy Wschodniej mogą wypływać z wszelkich środków, jakie Wspólnota Europejska będzie w stanie postanowić na tym polu.

Czas jest krótki

Kraje Europy Wschodniej mają około dwa lata — najwyżej trzy -na nieodwołalne zmiany w swoich systemach ekonomicznych. Proces reformatorski trwał niewątpliwie dość długo, ale pomimo, że większość fundamentalnych reform została zastosowana odpowiednio wcześnie, całkowity proces przeobrażeń może być zagrożony, a napływ zagranicznych kapitałów zahamowany. Obywatele ponoszący nieunikniony ciężar większej skali bezrobocia i obniżonego standardu życia w okresie przejściowym, będą prawdopodobnie tracili cierpliwość o ile poprawa nie będzie dostrzegalna. Bez zachodniego poparcia, zabiegi o przyspieszenie wzrostu i napływu prywatnego kapitału mogą być odłożone w nieskończoność, a impet ku pełnemu przekształceniu państw regionu w międzynarodowy system może uledz osłabieniu.

Cały proces ma dobrą szansę aby być doprowadzonym do sukcesu, o ile nastąpi przyspieszenie reform, a zewnętrzne wsparcie będzie wydajne. Chociaż kraje uprzemysłowione nie wątpiły w nadzieję na zmianę oblicza politycznego w Europie Wschodniej w minionych dwóch latach, to cały świat będzie odnosił istotne korzyści, gdy rejon stanie się ustabilizowany i dobrze zintegrowany z międzynarodową gospodarką. Z tego powodu, kraje uprzemysłowione wykazują silne zainteresowanie w otwarciu swoich rynków i rozszerzeniu szczodrej pomocy. Rządy regionu wykazują głębokie zainteresowanie w popieraniu przeobrażeń. Wspólnie powinni oni zjednoczyć wysiłki i wykazać zaangażowanie dla spełnienia tego historycznego wyzwania.

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The Summit Process and Collective Security: Future Responsibility Sharing

A Study Group Report

Group of Thirty, Washington, DC

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Table of Contents

Preface v

1. Introduction 1
The 1991 Summit 1
The Goal of this Paper 2
Main Recommendations 3

2. The Context For Reform 5
How the Summits Evolved 5
The Usefulness of the Summits 7

3. A New Core Agenda 9
The List 9
Simplifying the Issues 11
Policy Linkages and Trade-offs 11

4. Surveillance and Performance 13
Good Measures 13
A Scorecard of Nations 15
Caveats 16
Objective Monitors 20

5. Institutional Changes 21
Follow Through 21
Variable Geography 22
The Seven 23

6. Next Steps 25

Text Chart

1. The Linkages Between Core Agenda Topics 12

Text Tables

1. Performance Values 17
2. Performance Improvements 18
3. Key Countries Outside the G-7 24

Annex Tables

1. Savings 29
2. Inflation 30
3. Defense 31
4. Aid 32
5. Energy Intensity 33
6. Greenhouse Gas Emissions 34
7. Trade Liberalization 35
8. Arms Transfers 36

Preface

In October last year, after its autumn plenary meeting, the Group of Thirty set up a study group to examine burdensharing among nations. Sylvia Ostry, chairman of the Center for International Studies at the University of Toronto, chaired the study group. The other members were:

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Research Associate, the Institute for International Economics,
Washington, DC;

David Hale
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Charles R. Taylor
Executive Director of the Group of Thirty, Washington, DC.

This paper is the result of their consultations and discussions. All the members except Charles Taylor served in their personal capacity. This paper reflects their views, rather than the policies of their agencies, organizations or institutions.

1. Introduction

The 1991 Summit

The chief adversary of democratic capitalism has become its supplicant. Nowhere was this more evident than when Soviet President Gorbachev attended the 1991 G-7 Summit. This fact alone made the Summit an historic occasion that marked a turning point in world events.

But the problems of the Soviet Union and the other topical issues on the agenda this summer illustrated not so much the advent of a "new world order" as a potentially serious state of global disorder. They point to a more profound problem that needs to be faced urgently: how to strengthen the system of international cooperation among industrial nations.

This system is newly at risk. Made up of a latticework of institutions, policies and agreements among nations, its backbone is the common interests and mutual goodwill of the leading industrial countries. This goodwill is fraying at the edges and there are signs that nationalism is on the rise. In Europe and North America, renewed hostility toward Japan over its one-sided trade and investment flows is evident. In Japan, a nascent nationalism is finding political voice in a way that was unthinkable even a year or two ago. In several of the G-7 countries there are residual resentments about the way the Gulf War was waged and paid for.

Why is this? Many potential sources of tension existed in the past. Why is the atmosphere today less congenial than before?

The answer is that nationalist sentiments in each country were held in check by a common perceived external threat — the Soviet Union and its proxies. Now that Soviet adventurism in the Third World has waned, the Warsaw Pact is dismantled, the risk of invasion of Western Europe is greatly diminished and communism is a spent ideological force, the major industrial countries have lost some of their cohesive purpose. The imperative to subsume national interests behind common goals has been greatly weakened.

But many threats to collective security remain. They are just more diffuse, diverse and complex. They include: rising ethnic rivalries in several parts of the world; environmental deterioration; a weak global economy; narcotics trade and sporadic terrorism; continuing trade protectionism and barriers to investment; endemic poverty; and international migration on a disruptive scale. The objective need for collective leadership is arguably stronger than it ever was.

The Goal of this Paper

This paper reviews the sharing of responsibility for global security among the major industrial nations, considers the implications for the Summit process and makes some practical recommendations on strengthening the current system.

We talk about "responsibility" sharing rather than "burden" sharing because the issue is not always one of dividing up some common burden. For example, reciprocal trade liberalization should benefit both partners; and a nation that cleans up its own environment benefits as much as its neighbors — usually more. We discuss global "security" rather than global "governance", because there is no political will or mandate to give up as much national sovereignty as that term implies. We use the term "security" in a broad sense of providing for the secure welfare of people, and concentrate on those actions that entail providing international "public goods" through cooperation. By the "Summit process" we mean not only the annual Heads of State meeting, but also the preparation for and the follow-on from those meetings.

We focus on the G-7 and their Heads of State because, as is widely recognized, this is one of the most powerful and potentially effective groupings of nations. Between them, these seven countries account for two-thirds of world gross national product (GNP). They have a wide range of mutual interests that result from their common adherence to democratic forms of government, the strong economic ties among them and their similar high level of economic development. When they choose to endorse any major international initiative, there is usually a good chance of subsequent effective multilateral action.

Main Recommendations

We recommend that, before the next Summit, the Heads of State step back from the specific issues on their agenda and consider the more fundamental problem of providing for future world security. If they cannot fit together the pieces of a new world order, who can? Ad hoc solutions to some collective security problems have worked in the recent past — indeed, brilliantly so during the Gulf Crisis last year. But there is no reason to gamble that they will work as well in the future.

The Summit process itself should be strengthened, to lay a firm basis for future collective leadership. No doubt many things can be done toward this end. We advocate three practical steps:

- Set a new *core agenda* for future Summits — Urgent matters, like the aftermath of the Gulf Crisis and assistance for the Soviet Union will, of course, continue to have a major place in the Summit deliberations, but the Heads of State should regularly and systematically address several continuing issues.
- Define, manage and monitor *responsibility sharing* systematically and comprehensively — This would involve developing agreed performance measures and joint objectives and strategies among the G-7 countries in several areas.
- *Improve follow-on arrangements* for Summit initiatives — One possibility is to institute G-7 inter-ministerial meetings in addition to those for the finance ministers, along the lines of the European Community Council of Ministers mechanism.

The rest of this paper discusses and substantiates these recommendations in more detail.

2. The Context For Reform

How the Summits Evolved

Although they are called "Economic Summits", this has become a misnomer in recent years. The importance of economic policy coordination in the Summit process has declined. Even as the agenda has extended beyond macro-economic stabilization, the Summits' economic impact has become marginal. This year, there is manifest tension among the G-7 finance ministers on exchange and interest rate policies and, given how national interests are aligned, a major breakthrough will be difficult to achieve.

The Summits now are primarily political, and political circumstances have been in flux in the past five years or so. The staple issues of macro-economic policy coordination — monetary and fiscal policy, as well as exchange rate coordination and the systematic reduction of external imbalances — have seemed less significant beside the non-macro-economic problems that have arisen on narcotics, terrorism, the environment, the Soviet Union, the Gulf and the progress of the Uruguay Round of trade negotiations. The agenda has become event-driven and episodic.

Several trends have been at work for some time, contributing to the unstable global political landscape that has shaped the events on which Summit participants have concentrated. Among the most important long-term trends have been:

- the relative economic decline of the United States among the industrial countries;

- the corresponding rise in Japan's fortunes; and
- West European economic and political coalescence.

Three more recent seminal developments have been:

- the Soviet Union's collapse;
- its abandonment of Eastern Europe and the consequent economic and political transformation of that region; and
- the Gulf War's confirmation of the United States as the world's leading military power.

The main implication of the longer term trends is that the United States can no longer shoulder the burden for global security — military or otherwise — without European and Japanese participation. The political and economic benefits that accrue for the United States are increasingly likely to fall short of the costs, if it pursues global strategies unilaterally. Contrast the collective effort of setting up the European Bank for Reconstruction and Development (EBRD) to assist with the transformation of Eastern Europe and the Soviet Union with the unilateral initiative of reconstruction that the United States undertook at the end of World War II when it launched the Marshall Plan.

The more recent weakening of the Soviet Union and the allied success in the Gulf War have equally far-reaching implications. Not only has Eastern Europe been liberated, but throughout the Third World, totalitarianism is falling out of fashion.

Several nation states seem to be crumbling, pitting the principles of self-determination and national sovereignty against one another. Which side should the industrial countries take in regional and civil conflicts?

The experience of collective leadership in the Gulf War was not all positive. True, the United States and its allies formed and mobilized an extraordinarily effective multilateral force, but the ad hoc approach used there had some shortcoming. The distribution of risks and burdens remains controversial as does the resulting political condition of Iraq and the rest of the Middle East.

In sum, the distribution of national power has changed enormously since the Summits began. This was a major factor pulling the agenda of the Summits away from purely macro-economic policy coordination toward the particular political events of the day. Now perhaps the underlying long-term trends and recent seminal developments, and their implications for future security, should be collectively addressed.

The Usefulness of the Summits

The Summits are popular among the participating Heads of State for personal and political reasons. They are a chance to talk to their peers and demonstrate their membership in an exclusive club, and for the statesmanlike photo opportunities they provide. (These are important as reasons why the Summit process is durable.) More substantively, the Summits establish personal links that improve communication and reduce the chances of misunderstandings among the seven nations, particularly in times of crisis.

But have they materially furthered policy coordination? This is a controversial, much studied subject. It has been difficult to judge what would have happened without any coordination and to decide now much coordination has been the result of the Summits, as opposed to other initiatives at different levels and in different forums. Still, most informed observers and policymakers would probably agree that there were occasions when economic coordination in general and the G-7 Summits in particular were effective and beneficial, such as:

- the Bonn Summit, for macro-economic adjustment;
- the Louvre Accord, for currency stabilization; and
- the Houston Summit, for the endorsement of the EBRD, and the approach to the aid to Eastern Europe and the Soviet Union.

While coordination efforts in other spheres, such as defense or the environment or trade liberalization are equally difficult to measure, they are if anything more clearly necessary and mutually beneficial. For example, the compatibility of equipment and strategy achieved in NATO in the past 10 years was important to the alliance in the Gulf. Equally, the protection of Western Europe for the past 40 years depended entirely on high levels of cooperation within NATO. But, on defense, the Summits have not added a great deal. More important have been NATO, the US bilateral initiatives and, recently, the Western European Union (WEU) and the Council on Security Cooperation in Europe (CSCE), and even the UN Security Council.

The evidence suggests that Summits do work, but not with predictable efficacy. They have probably been useful in macro-economic coordination and in launching — or supporting — institutional initiatives in other areas. But their coverage of issues has been uneven.

The question now is, how can their batting average be improved?

3. A New Core Agenda

Our first proposal is to split the Summit agenda into two: a new "core agenda" and a topical agenda. The Summit will always be event-driven and crisis-oriented to some extent, so that the topical agenda will inevitably take up a large part of the time. But a core agenda that deals with a defined list of issues of ongoing policy coordination and cooperation would be a valuable addition. For it would allow the Heads of State to review progress and priorities and, at the same time, should set the stage for a balanced and more shared perspective on the discussion of the topical agenda.

The List

For the core agenda to be useful, it has to be comprehensive and, at the same time, it has to be structured and short. It cannot leave out important subjects and it cannot have 20 or 30 items. There are now few matters of state that are purely domestic — thanks to the effects of international trade, investment, communications and travel on our national economic and cultural lives. The range of issues to cover is wide. It follows that each of the few topics on the core agenda must be fairly broad. Here are five candidates:

- *Aid* — including debt relief and debt reduction. Since the debt crisis of the early 1980s, it has been a recurrent Summit topic. It now embraces the Soviet Union and Eastern Europe. But it also is a vital part of government-to-government relations between the industrial nations and the Third World. How aid programs develop in the future will influence international migration, poverty alleviation and the furtherance of human rights.

- *Environment* — an international concern for many years, but a matter of high politics for only the past few years as the extent of what is at stake has become clear.
- *Trade and investment* — increasingly two sides of the same coin, and both related to the issues of market and technology access. They have only been summarily tackled as Summit topics. While trade and investment liberalization have been critical to economic growth over the past forty years, they still raise difficult domestic political issues in every G-7 country.
- *Defense* — incuding arms control and other international matters that involve protecting the weak by the threat and force of arms, such as coordinated action against drug trafficking and terrorism. Drug trafficking and terrorism have been on the Summit agenda in the past and have slipped off. National defense has not been, but in the wake of the Gulf Crisis, it may well be if the Heads of State take the view that they have common defense interests that may not be addressed as such in the plethora of other international forums that deal with the subject.
- *Economic Policy Coordination* — including short-term stabilization and long-term structural adjustment. Short-term economic stabilization — macro-economic policy coordination — has been the only item on the core agenda in the past, and there it should stay. But, in addition, structural adjustment aimed, for example, at lowering chronic deficits or surpluses or raising savings rates, deserves a place on the agenda.

It may be that the various sub-topics subsumed here could be rearranged in some other way. Equally, there may be a compelling case that could be made for the addition or subtraction of a specific sub-topic from consideration within the core agenda. But broadly speaking, these major topics, as they are defined here, do seem to capture the issues of common welfare that require high-level agreement for effective policy coordination, where collective leadership by the G-7 could play a critical constructive role.

Simplifying the Issues

Each of these five topics is immensely complex in its own right. Defense cooperation, for example, requires (i) agreed objectives, (ii) acceptable apportionment of the costs, risks and responsibilities and (iii) a shared strategy. In addition, (iv) tactics, and systems of (v) command, (vi) organization and (vii) weapons must all be reasonably compatible.

There is a comparable hierarchy of tasks that can be coordinated for each item on the core agenda — and for several sub-items too, such as efforts to combat drug trafficking.

However, the Summit need only consider the broad objectives, the apportionment of responsibilities, and strategy. And, of course, like any corporate board, it only need consider the points on the agenda where there have been material developments or where material policy changes are deemed necessary.

Policy Linkages and Trade-offs

In the future, the Summits should have a special role in managing the links between international policies in different areas and in establishing trade-offs between nations.

Linkages, such as those between trade and defense, are well recognized: trade in defense-related technology has long been controlled and the issue of its effect on competitiveness among the G-7 is well identified, although not resolved; post Cold War, arms sales to developing countries are under scrutiny; in the Gulf Crisis aftermath, the proliferation of weapons of mass destruction have become a major issue.

Equally, aid and the environment are interlinked through conditionality and the composition of national and multilateral aid programs. Global poverty is related to environmental depredation, as well as to terrorism, migration and the drug trade.

Macro-economic policy coordination and trade are linked through the politics of protection and through the effects of the business cycle, structural adjustment and exchange rates on trade flows.

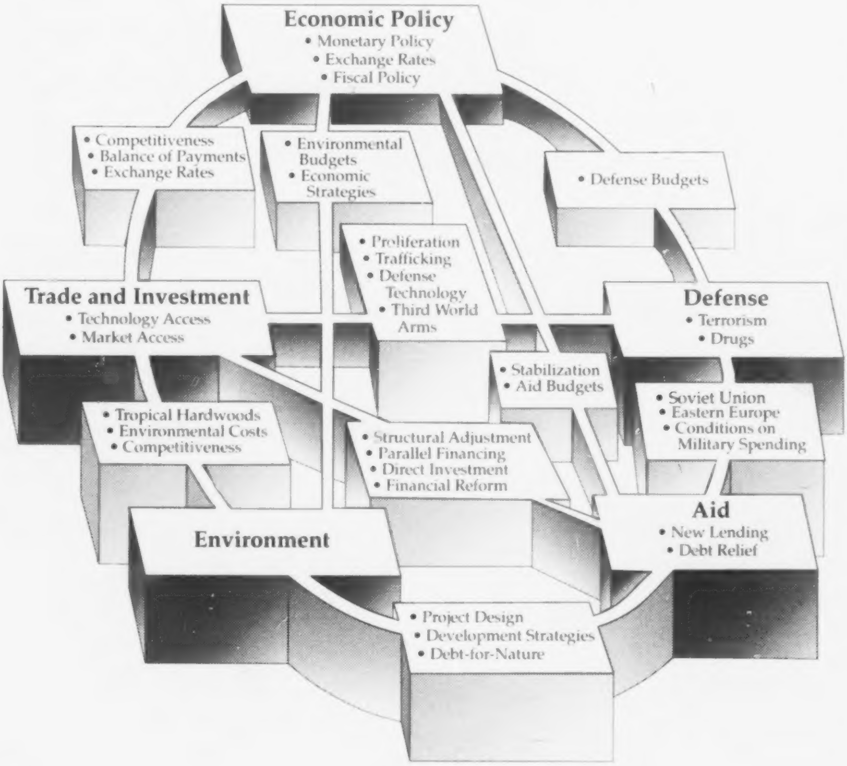
Chart 1 illustrates these and other links between agenda items:

several require high-level coordination.

Regarding trade-offs, past experience suggests that, as a rule, they work best between closely related issues. A bargain such as "the United States will do more for defense in the Gulf if Germany does more for defense in Northern Europe" is likely to be more acceptable and durable than one across disparate subjects — such as "Japanese aid for US defense." But the very different comparative advantages of the G-7 countries and increasing sensitivity about sharing responsibilities means that in the future some of these further-ranging trade-offs may have to be made. In that case, the challenge is to make them more durable and to ensure as far as possible that each nation does bear its "fair share" overall.

Where both trade-offs and interlinkages are concerned, the Heads of State are uniquely placed to set up problem-solving frameworks and to direct resources toward cooperative solutions.

Chart 1. The Linkages Between Core Agenda Topics


Economic Policy
• Monetary Policy
• Exchange Rates
• Fiscal Policy
• Competitiveness
• Balance of Payments
• Exchange Rates
• Environmental Budgets
• Economic Strategies
• Defense Budgets
• Proliferation
• Trafficking
• Defense Technology
• Third World Arms
Trade and Investment
• Technology Access
• Market Access
Defense
• Terrorism
• Drugs
• Stabilization
• Aid Budgets
• Soviet Union
• Eastern Europe
• Conditions on Military Spending
• Tropical Hardwoods
• Environmental Costs
• Competitiveness
• Structural Adjustment
• Parallel Financing
• Direct Investment
• Financial Reform
Aid
• New Lending
• Debt Relief
Environment
• Project Design
• Development Strategies
• Debt-for-Nature

4. Surveillance and Performance

Our second proposal is there be an agreed surveillance system supporting the Summit deliberations. It may be possible to identify objectives, but the refinement of strategy and discussion of responsibilities is impossible without some common understanding of the relative and absolute performance of different countries — in the first instance, of the G-7 countries themselves.

Such a system already exists in one area — macro-economic policy coordination. In each other area of aid, defense, the environment and trade and investment liberalization, there are systems of performance monitoring at different stages of development. How surveillance and performance monitoring *within* each area should be refined and developed we will touch on briefly at the end of this section. First we consider what would constitute good performance measures and, at the highest level, what summary measures of performance might look like.

Good Measures

Ideal measures of performance would credit countries for their contribution to global public goods; "goods" in the broadest sense of things that improve global security or welfare that are "public" in the sense that it is difficult to exclude any country from the benefits. A protected ozone layer or a more peaceful world are examples of global public goods. And performance measures should ideally capture a nation's efforts that go over and beyond what directly benefits itself.

In addition, good measures would be:

- *relevant* — actionable and important;

- *reductive* — summarize a great deal of information;
- *clear* — easy to understand;
- *monitorable* — available in a timely fashion;
- *proportionate* — to the ability of a country to contribute, perhaps in terms of its population or GNP or gross domestic product (GDP);
- *precise* — but not spuriously accurate or arbitrary;
- *discrete* — meaning non-overlapping aspects of performance, to avoid double counting and netting problems;
- *robust* — leading to results insensitive to small changes in definitions and methods; and
- *comparable* — through some theory that assigns weights and determines a calculus of aggregation or through some rougher method of joint presentation.

However, these are ideals. In the real world of international policy coordination, statistics are defined differently in different countries; there are basic differences about objectives, priorities, and strategies and therefore different views about what ought to be measured; and there are different views about how policy instruments affect objectives. Because of lags in data collection, recent measures are often tentative and current measures are often estimated and subject to major revisions. And there are several conceptual problems, not least those to do with the very notion of global public goods.

These real world shortcomings can be easily used to argue against summary measures of performance for surveillance and policy coordination. But in fact a great deal of work on performance monitoring has already been done. There is, for example, a large body of research on macro-economic policy coordination and performance measurement. Of the five topics on the proposed core agenda, the environment is probably the area where there is least information and analysis. The shortcomings of current information are, by and large, *a priori* grounds for continuing the effort to improve and refine performance measures across the proposed core agenda.

In any case, performance measurement needs to be supplemented by commentary if the resulting assessment is to be reasonable and acceptable. Unquantifiable aspects of policy coordination and responsibility sharing — such as cooperation among central banks in the macroeconomic sphere and cooperation on development policy in the area of aid — need to be acknowledged to produce a balanced assessment of overall performance in sharing responsibility for global security.

A Scorecard of Nations

Future improvements in measures and our understanding the related theoretical issues should contribute to better policy coordination within each area. In the meantime, we can illustrate the idea using seven very simple measures:

- *Economic Policy Coordination: national savings as a percent of GNP or GDP* — a measure of how much a country is contributing to funds available for worldwide investment in relation to its ability to save. It captures the effect of tax and expenditure policies on savings rates in the household and corporate sectors as well as the management of the fiscal deficit.
- *Economic Policy Coordination: the annual inflation rate* — a measure of how effective monetary policies have been.
- *Defense: military expenditures as a percent of GNP or GDP* — a measure of the military effort, in relation to a country's economic resources.
- *Aid: Net disbursements of official development assistance as a percent of GNP or GDP* — a measure of the level of actual aid flows from a country, in relation to its ability to extend aid.
- *Environment: energy usage per thousand dollars of GNP or GDP* — a measure of the natural resource intensity of an economy.
- *Environment: greenhouse gas emissions* — a composite measure of carbon dioxide, methane and CFC emissions that capture a key effect of economic activity on the global environment, in relation to the scale of activity.
- *Trade Liberalization: non-fuel imports as a percent of GNP* — a measure of how open an economy is to trade in manufactured goods, services and agricultural commodity imports.

Table 1 shows how the performance of the G-7 countries compares using these measures. The index values shown here are the average values of the measures in question, for the last five years for which they are available. The exception is the environmental measure, which is in kilograms of greenhouse gas emissions per thousand dollars of GNP, for which a single measure is available for the 1980s. Table 1 is based on Annex Tables 1, 2, 3, 4, 6 and 7.

This table also ranks the relative performance of the G-7 countries in these different areas. It shows that no country has strikingly superior — or inferior — performance across all indices. Germany is the only country where all the indicators are similar, and it ranks between second and fourth on all six indices. And yet performance on individual indices does vary considerably, suggesting that, in gauging responsibility sharing, it is not only natural but also necessary to take performance in several areas into account.

Table 2 shows the annual percentage change in these measures, averaged over the past five years. For the change in the environmental measure, the energy usage per $1,000 of GNP was substituted for greenhouse gas emissions, for which no time series data are available. The energy usage data is summarized in Annex Table 5.

This table also indicates how much relative progress each country made in improving its performance. Here some countries appear to be doing better than average, such as Japan and France.

Tables 1 and 2 are illustrative. It should be possible to refine measures of this kind to the point where they can be applied in the Summit process. They should serve as useful points of reference for discussing responsibility sharing and assessing priorities at the broadest level.

Caveats

How good are these illustrative summary indices? They certainly fall short of some of the ideal desirable characteristics. For example, the control of greenhouse gas emissions is desirable from a national and a global perspective. This measure cannot begin to distinguish between how much environmental effort should be considered a national benefit and how much a contribution to global responsibility sharing. And there

Table 1. Performance Values

Country	*Savings*	*Inflation*	*Defense*	*Aid*	*Environment*	*Trade*
Ranking						
Canada	5	5	6	2	7	1
France	4	3	3	1	2	4
Germany	2	2	4	3	4	3
Italy	3	7	5	4	3	5
Japan	1	1	7	6	1	7
United Kingdom	6	6	2	5	6	2
United States	7	4	1	7	5	6
Index Values						
Canada	19.8	2.6	2.1	0.47	608	22.0
France	20.4	2.5	3.9	0.51	395	17.1
Germany	25.0	2.2	3.0	0.42	488	19.6
Italy	20.8	3.9	2.4	0.36	465	15.0
Japan	33.1	1.4	1.0	0.31	268	5.3
United Kingdom	16.3	3.4	4.6	0.31	599	21.4
United States	14.7	2.5	6.4	0.21	558	8.4

Note: Savings, defense, aid and trade are all ranked higher, the higher the average value of the index over the last five years, and inflation and the environment are ranked higher, the lower the average value of the index.
Index Units: (1) Savings: national savings as a percent of GNP; (2) Inflation: annual rate of increase in the GNP/GDP deflator; (3) Defense: military expenditures as a percent of GNP/GDP; (4) Aid: net disbursements of official development assistance as a percent of GNP/GDP; (5) Environment: kilograms of greenhouse gas emissions per $US 1,000 of GNP/GDP; (6) Trade: non-fuel imports as a percent of GNP/GDP.
Source: Annex Tables.

are many aspects of international environmental responsibility sharing — trade in tropical hardwoods (see Chart 1), international river management, use of the oceans, support for international institutions — that are not reflected at all in this one measure.

Equally, the measurement of economic performance and the coordination of macro-economic and structural adjustment policies raise difficult, much debated issues. Should performance (and compliance with

Table 2. Performance Improvements

Country	*Savings*	*Inflation*	*Defense*	*Aid*	*Environment*	*Trade*
Ranking						
Canada	4	7	4	6	5	7
France	2	1	5	2	3	1
Germany	1	3	6	5	1	5
Italy	5	4	1	1	7	6
Japan	3	2	2	3	2	2
United Kingdom	6	6	7	3	6	4
United States	7	5	3	7	3	3
Change in Index Values						
Canada	-0.7	29.7	-1.9	-2.4	-0.6	-1.7
France	2.1	2.9	-2.0	1.0	-0.9	2.8
Germany	4.0	18.5	-2.6	-1.6	-1.4	0.7
Italy	-1.1	20.5	1.0	7.9	0.0	-0.6
Japan	1.4	16.9	0.0	-0.9	-1.3	2.2
United Kingdom	-1.6	23.7	-4.6	-0.9	-0.4	0.8
United States	-2.1	21.3	-1.2	-8.2	-0.9	1.7

Note: Savings, defense, aid and trade are all ranked higher, the higher the value of the average percent change in the index over the past five years, and inflation and environment are ranked lower, the greater the average change.
Source: Annex Tables.

agreed coordination goals) be judged by looking at policy instruments, such as the discount rate, or at intermediate variables, such as the rate of increase in nominal domestic demand, or at final objectives, such as the rate of inflation, as we have suggested for illustrative purposes here?

None of our illustrative measures is comprehensive:

- *Economic policy* — inflation and savings: these are measures of the success of macro-economic policy over the longer term. They subsume several structural issues and they do not directly reflect progress in the management of, for example, disequilibria, such as those in the external account, which worried policymakers for several years during the 1980s — and still do.
- *Defense* — there are many other aspects to defense burdensharing.

This measure takes no account of lives at risk in combat. Nor does it reflect differences in effectiveness of expenditures: for example, it is argued that Germany's reserve system very economically provides a major contribution to Western European security. In addition, neither the positive effects of national efforts to combat drugs trafficking and terrorism, nor the negative effects of arms trade (see Annex Table 8) are reflected in this measure.

- *Aid* — this measure misses the direction and quality of aid. Is it to poor countries? Is it tied? Does it finance well-conceived projects? These are critical factors to take into account when assessing responsibility sharing. It does not take account of official debt relief or, for that matter, private debt relief.
- *Energy intensity* — this index reflects several things other than the impact that economic activity has on the environment through resource depletion and pollution, such as the sectorial structure, geography and climate of a country. (Average *changes* in the index over several years, as we use the measure here, should be free of most climactic influences and of geographic effects.) It does not reflect the level of environmental effort, much of which is mandated by government but actually executed in the private sector in all the G-7 countries.
- *Non-fuel imports as a percent of GNP* — this index is clearly affected by geography — the remoteness of Japan, trade within the European Community and the relative self-sufficiency of the US economy. Like the energy intensity measure, average *changes* over several years seem to be free of arbitrary historical and geographic influences, suggesting it is decidedly more useful in Table 2 than in Table 1. Measures for investment and technology flows would also have to be developed.

With these caveats and with appropriate interpretation and commentary, our illustrative measures reflect important aspects of responsibility sharing. As measures, they are relevant, reductive, clear, proportionate, precise, discrete and comparable. They may not be as robust as one might like. And they may not be as timely as might be desirable — for example, as they have been compiled here from published international sources, they do not reflect military burdensharing in the Gulf — but then no available comprehensive numbers do. Such issues have to be discussed in qualitative terms and in more specific frameworks.

These measures have been compiled and tabulated here not as an attempt to have the last word but to stimulate some discussion on the issue of measuring performance among the G-7 countries across several areas of shared responsibility.

Objective Monitors

Each policy area needs to be monitored objectively and international institutions exist that are capable of doing just this:

- the IMF, for economic policy;
- the World Bank and the Development Assistance Committee of the Organization for Economic Cooperation and Development (OECD), for aid;
- the OECD for the environment — coordinating with UN and regional bodies; and
- the GATT for trade and investment.

It would seem sensible for the Heads of State to delegate the question of improving performance measures and surveillance mechanisms within each area to the institution(s) concerned. They should also be tasked with developing acceptable summary measures for the Heads of State to use in their overall assessments of performance and responsibility sharing.

It is less clear that there is an appropriate organization for defense monitoring. NATO, the CSCE and the WEU are all regionally circumscribed. The US Defense Department does report on "NATO plus Japan" in its annual studies of burdensharing, but no corresponding organization exists. Equally, although there is an organization for coordinating police work internationally — Interpol. Does it need strengthening, even to play a role as an effective monitor of drug trafficking efforts?

5. Institutional Changes

Follow Through

Our third recommendation is to strengthen the Summits' follow-through mechanism.

At present, the impact of the annual Summits is a hit or miss affair. Some initiatives take on a life of their own and prosper. Others die. Perhaps a process of natural selection is at work and the fittest proposals do in fact survive but, given the informality and generality of the Summit process, it would be remarkable if some important opportunities were not occasionally lost.

Some observers suggest a permanent secretariat is needed. But surely the necessary capacity for administration already exists in each of the seven governments involved? It is more a question of providing for detailed coordination across several fields.

One way would is to make better use of existing institutions. For example, it is current practice for the.IMF's managing director and chief economist to be present for some G-7 Finance Ministers meetings. But IMF officials are regularly excluded from certain key discussions. This seems to fly in the face of the reason why the institution was set up in the first place.

Equally, the GATT's current weakness is more a function of a lack of the political will needed to resolve outstanding trade and investment issues than any technical or organizational shortcomings of the GATT Secretariat. It is quite capable of follow through, provided the Summits generate clear mandates for action on trade and investment issues.

A third alternative may be to emulate the European Council of Ministers in some respects. This operates, of course, in a very different political and institutional setting. It is an executive body, issuing regulations, directives, decisions as well as recommendations and opinions in conjunction with the European Commission. But it does steer the affairs of the European Community much as the G-7 Summits might steer the affairs of the industrial countries as a group, and its working methods are somewhat similar, in that politicians can and do meet with neither civil servants nor experts present.

There are three aspects of the Council's operations the Summit might adopt:

- The Heads of State meet twice a year, making for continuity and for a less event-driven agenda;
- In between, ministers of agriculture, transport, economic and financial affairs, industry, social affairs, industry and the environment get together (There were a total of 87 meetings in 1989); and
- When, at the Heads of State Council Meetings, a particular topic comes up, such as agriculture, the agricultural ministers will be present and can take a part.

Close involvement of the specialist ministers, although it will be resisted by the economic and finance ministers, seems appropriate, as the G-7 Summits have broadened in scope. There might, for example, be a case for the G-7 defense ministers meeting to work on post Cold War security strategy for the industrial countries. Or they might get together with their aid ministers — relative political importance notwithstanding — to develop a joint approach to the question of development and arms sales to developing countries. The details of the interlinkages and trade-offs which the Summits identified could be worked out between times by the specialist ministers concerned.

Variable Geography

Many responsibility sharing issues cannot be settled completely among the G-7 countries. The geography of issues varies. Other countries may need to be brought into decisionmaking and joint action and may, therefore, be given an active role in the Summit process — if not in the Summit of the Heads of State itself. Mr. Gorbachev's attendance at the 1991 London Summit a case in point.

Equally, India and China are major contributors to the greenhouse effect and any Summit initiative on global warming must involve them early on. Similarly, on energy issues, Saudi Arabia might be involved. On arms control — an aspect of security arrangements — major European and developing country producers could also play a part (Table 3).

The timing and manner in which additional countries are brought in to participate in decisionmaking and subsequent actions is something the G-7 governments may sometimes have to settle outside Summits, in the heat of a crisis. How such crisis corralling will be done, and who will be involved on chronic issues are, however, proper topics for the Summit itself.

The Seven

Several observers wonder if the present European nations should be represented collectively at the European Community level, resulting in a G-4 rather than a G-7. Or perhaps Canada should drop out and it should become a G-3. A G-4 or G-3 might be tidier, but would it strengthen the Summit process materially?

Certainly, there would be less scope for European Heads of State and their ministers to cross wires, if they were represented collectively at the Summits. But, if the Summits political force is to increase rather than decrease, consolidation should await the day of real political union in Western Europe.

Canada's continuing participation is an anomaly — but, by all accounts, a welcome one. It can and does act as honest broker between the larger powers. With a open, medium-sized economy, Canada is uniquely interested among the Seven in maintaining the multilateral institutions. In many respects, it effectively represents the smaller industrial economies.

Table 3. Key Countries Outside the G-7

Core Agenda Issue	*Subsidiary Issue*	*Countries*	*Rationale*
Economic	Macro-coordination	None	G-7 dominant
	Energy Market Stability	Saudi Arabia	Swing oil producer. Possibly other major net exporters/producers: the Soviet Union?
Defense	Military —Gulf	GCC members	Key states at risk.
	—Europe	WEU members, CSFR, Hungary and Poland	Key states at risk.
	Arms Proliferation	Brazil, South Africa, Israel, CSFR, Soviet Union	Key arms manufacturers.
	Narcotics	Turkey, S.E. Asia Asia and Latin American producers	For joint action by key producers and users
	Terrorism	Soviet Union	To assure harboring terrorism is penalized.
Aid	Aid and Debt Relief	None	G-7 leads donor groups in all major forums.
Environment	Global Warming	Brazil, India and China	Jungle burning and fossil fuel use.
Trade and Investment	Trade Liberalization	None	The central issues are between the G-7 and EC Countries themselves.
	Technology Access	None	The central issues are between the G-7 and EC Countries themselves.
	Investment Access	None	The central issues are between the G-7 and EC Countries themselves.

6. Next Steps

How can the Munich Summit in 1992 make progress on the issue of sharing responsibility for collective security?

On the first and second recommendations in this report, the Heads of State could decide to commission a responsibility sharing study — though it is far from clear who would take on such a task. Or they might experiment with a core agenda at their next meeting and look to the existing agencies to improve their surveillance and monitoring of G-7 performance with a view to informing that core agenda discussion.

On the third recommendation of improved follow on, assistance to the Soviet Union may provide an opportunity to set useful precedents. Not only must the bilateral and multilateral aid agencies work together closely, but defense questions should also be addressed. The interlinkages have to be made. One way would be to direct their aid and defense ministers to address the matter collectively.

It might also be argued that a new strategy for the industrial countries toward the developing world is called for. The old hypocrisy whereby development aid was given with one hand and arms were given with the other is no longer tenable. Managing the environment in the developing countries, migration to the industrial countries, what to do when somewhat arbitrarily-defined nation states show signs of collapse, and the development of liberal economic and political systems in the Third World should be considered together.

We noted that, when it came to monitoring performance, there was no clear candidate organization in the area of defense. Is a new organization needed? This is an issue to consider in the context of the follow on to any Summit discussion of the aftermath of the Gulf War. What should joint industrial country objectives be? How should combat responsibilities been shared in the future? The Summit is an appropriate place for institutional initiatives to originate.

This is a difficult period for international policy coordination. Nation states are weakening — mostly outside the industrial world. But the G-7 countries, with the exception of Canada, all seem reasonably secure of their national identities — even those within Europe.

Global security can only be provided through cooperation and the list of issues that need to be addressed collectively is as long as ever. Yet the imperative for cooperation — a common, readily perceived and well-defined external threat — among the major industrial countries is weaker now than it has been. To combat this tendency, strengthening the Summit process itself should be among the first international priorities of the G-7 Heads of State in the immediate future.

Annex Tables

Annex Table 1. Savings
National Savings, 1985-1990
(Percent of GNP/GDP)

							Averages	
Country	*1985*	*1986*	*1987*	*1988*	*1989*	*1990*	*Value*	*Change*
Canada	20.2	18.5	19.6	21.1	20.4	19.3	19.8	-0.74
France	19.0	20.0	19.6	20.5	21.1	21.0	20.4	2.08
Germany	22.1	23.9	23.6	24.5	26.1	26.9	25.0	4.05
Italy	21.8	21.3	20.7	20.9	20.6	20.6	20.8	-1.07
Japan	31.6	31.9	32.3	33.3	34.0	33.9	33.1	1.39
United Kingdom	15.8	14.7	14.5	15.1	15.2	14.1	14.7	-2.09
United States	17.7	16.3	16.3	16.4	16.0	16.3	16.3	-1.58

Note: 1989 and 1990 values are from IFS and 1990 values are estimated.for Canada and Japan (based on Q1, Q2, and Q3 data), France (based on Q1 and Q2 data) and Italy, which is assumed equal to 1989. IFS data on total GNP/GDP, minus government and private consumption was used to estimate national savings rates.

Source: OECD *Economic Outlook*, December 1990, and various issues of IMF *International Financial Statistics* (IFS).

Annex Table 2. Inflation
GNP/GDP Deflators, 1985-1990
(Percent)

							Averages	
Country	*1985*	*1986*	*1987*	*1988*	*1989*	*1990*	*Value*	*Change*
Canada	1.6	1.8	2.2	1.7	2.7	4.8	2.6	29.7
France	4.1	3.2	2.2	1.8	2.0	3.5	2.5	2.9
Germany	2.2	2.4	2.2	1.4	1.6	3.4	2.2	18.5
Italy	4.6	4.1	3.0	2.5	3.0	7.1	3.9	20.5
Japan	1.3	1.6	0.9	1.1	1.3	2.1	1.4	16.9
United Kingdom	2.4	2.2	2.0	2.7	4.2	6.1	3.4	23.7
United States	1.8	2.0	2.0	1.7	2.8	4.1	2.5	21.3

Note: 1990 values are estimated for Canada (based on consumer prices), France (based on Q1 and Q2 data) and Italy and Japan (both based on Q1, Q2 and Q3 data).
Source: IFS.

Annex Table 3. Defense
Military Expenditures, 1984-1989
(Percent of GNP/GDP)

							Averages	
Country	*1984*	*1985*	*1986*	*1987*	*1988*	*1989*	*Value*	*Change*
Canada	2.2	2.2	2.2	2.2	2.1	2.0	2.1	-1.86
France	4.1	4.0	3.9	4.0	3.9	3.7	3.9	-2.00
Germany	3.2	3.2	3.1	3.0	2.9	2.8	3.0	-2.63
Italy	2.3	2.3	2.3	2.5	2.6	2.4	2.4	1.00
Japan	1.0	1.0	1.0	1.0	1.0	1.0	1.0	0.00
United Kingdom	5.2	5.2	4.9	4.6	4.3	4.1	4.6	-4.61
United States	6.3	6.6	6.6	6.5	6.3	5.9	6.4	-1.24

Source: US Arms Control and Disarmament Agency: *World Military Expenditures and Arms Transers,* 1989.

Annex Table 4. Aid
Net Disbursements of Official Development Assistance, 1984-1989
(Percent of GNP/GDP)

							Averages	
Country	*1984*	*1985*	*1986*	*1987*	*1988*	*1989*	*Value*	*Change*
Canada	0.50	0.49	0.48	0.47	0.49	0.44	0.47	-2.41
France	0.52	0.54	0.48	0.51	0.50	0.54	0.51	1.00
Germany	0.45	0.47	0.43	0.39	0.39	0.41	0.42	-1.65
Italy	0.33	0.26	0.40	0.35	0.39	0.42	0.36	7.85
Japan	0.34	0.29	0.29	0.31	0.32	0.32	0.31	-0.92
United Kingdom	0.33	0.33	0.31	0.28	0.32	0.31	0.31	-0.92
United States	0.24	0.24	0.23	0.20	0.21	0.15	0.21	-8.16

Note: Data for France excludes ODA for overseas departments and territories (Dom/Tom).
Source: OECD, *Development Assistance Committee Reports* for 1990 and previous years.

Annex Table 5. Energy Intensity
Tons of Oil Equivalent, 1984-1989
(Per $US 1,000 GNP/GDP)

							Averages	
Country	*1984*	*1985*	*1986*	*1987*	*1988*	*1989*	*Value*	*Change*
Canada	0.66	0.66	0.65	0.64	0.64	0.64	0.65	-0.61
France	n.a.	0.38	n.a.	n.a.	0.37	n.a.	0.38	-0.88
Germany	0.43	0.43	0.42	0.42	0.41	0.40	0.42	-1.43
Italy	0.33	0.33	0.33	0.33	0.32	0.33	0.33	0.02
Japan	0.30	0.28	0.27	0.26	0.27	0.28	0.27	-1.28
United Kingdom	0.43	0.44	0.44	0.42	0.41	0.42	0.43	-0.43
United States	0.46	0.45	0.44	0.44	0.44	0.44	0.44	-0.88

n.a. means data are not available.
Note: 1989 are IEA Secretariat estimates. GNP/GDP are measured at 1985 prices and compared at 1985 exchange rates. The french analysis is based just on the two years, 1985 and 1988.
Source: OECD and the International Energy Agency: *Energy Policies and Programmes of IEA Countries*, 1990.

Annex Table 6. Greenhouse Gas Emissions Kilograms of Emissions, Late 1980s

(Per $US 1,000 GNP/GDP)

Country	*Late 1980's*
Canada	608
France	395
Germany	488
Italy	465
Japan	268
United Kingdom	599
United States	558

Note: Emissions are measured in equivalent carbon dioxide heating effect. The main gases involved are carbon dioxide, methane and the CFCs.
Source: OECD: *Environmental Indicators* 1991.

Annex Table 7. Trade Liberalization
Non-fuel Imports, 1985-1990
(Percent of GNP/GDP)

							Averages	
Country	*1985*	*1986*	*1987*	*1988*	*1989*	*1990*	*Value*	*Change*
Canada	22.4	23.2	22.0	22.7	21.5	20.5	22.0	-1.69
France	16.1	15.5	16.0	17.2	18.6	18.4	17.1	2.81
Germany	20.3	18.9	18.4	19.2	20.8	20.8	19.6	0.66
Italy	15.9	13.8	14.4	15.4	16.2	15.2	15.0	-0.57
Japan	5.6	4.6	4.7	5.2	5.9	6.1	5.3	2.24
United Kingdom	20.6	20.7	20.8	21.5	22.4	21.4	21.4	0.83
United States	7.6	8.2	8.3	8.6	8.5	8.2	8.4	1.72

Note: Trade excludes SITC3, which is mineral fuels, lubricants and related materials.
Source: OECD: *Foreign Trade by Commodity 1989 and 1990* and IFS.

Annex Table 8. Arms Transfers
Transfers to Developing Nations, 1983-1988

(Percent of GNP/GDP)

Country	*1983*	*1984*	*1985*	*1986*	*1987*	*1988*	*Averages*	
							Value	*Change*
Canada	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
France	0.80	0.82	0.90	0.55	0.28	0.19	0.5	-21.69
Germany	0.24	0.42	0.10	0.03	0.07	0.02	0.1	-2.84
Italy	0.29	0.27	0.21	0.08	0.03	0.05	0.1	-18.35
Japan	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
United Kingdom	0.28	0.30	0.15	0.16	0.26	0.04	0.2	-11.99
United States	0.20	0.14	0.15	0.12	0.20	0.16	0.2	0.77

n.a. means data is not available.
Source: US Arms Control and Disarmament Agency *World Military Expenditures and Arms Transfers*, 1989 and IFS.

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